Multistate Tax Commission

States Working Together Since 1967. . .
To Preserve Federalism And Tax Fairness

MODEL REGULATIONS, STATUTES AND GUIDELINES

Uniformity Recommendations to the States

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TABLE OF CONTENTS

INTRODUCTION: *Preserving Federalism and Tax Fairness Through Voluntary State Tax Uniformity* by Dan R. Bucks, MTC Executive Director i

MODEL REGULATIONS

Corporate Income Tax Allocation and Apportionment Regulations 1

IV.1.(a). Business and Nonbusiness Income Defined 2
IV.1.(b). Two or More Businesses of a Single Taxpayer 2
IV.1.(c). Business and Nonbusiness Income: Application of Definitions 3
IV.1.(d). Proration of Deductions 7
IV.2.(a) Definitions 8
IV.2.(b)(1). Application of Article IV: Apportionment 8
IV.2.(b)(2). Application of Article IV: Combined Report 8
IV.2.(b)(3). Application of Article IV: Allocation 8
IV.2.(c). Consistency and Uniformity in Reporting 9
IV.3.(a). Taxable in Another State: In General 9
IV.3.(b). Taxable in Another State: When a Corporation Is "Subject to" a Tax 9
IV.3.(c). Taxable in Another State: When a State Has Jurisdiction to Subject A Taxpayer to a Net Income Tax 11
IV.9. Apportionment Formula 11
IV.10.(a). Property Factor: In General 11
IV.10.(b). Property Factor: Property Used for Production of Business Income 12
IV.10.(c). Property Factor: Consistency in Reporting 12
IV.10.(d). Property Factor: Numerator 13
IV.11.(a). Property Factor: Valuation of Owned Property 13
IV.11.(b). Property Factor: Valuation of Rented Property 14
IV.12. Property Factor: Averaging Property Values 16
IV.13.(a). Payroll Factor: In General 17
IV.13.(b). Payroll Factor: Denominator 18
IV.13.(c). Payroll Factor: Numerator 18
IV.14. Payroll Factor: Compensation Paid in This State 19
IV.15.(a). Sales Factor: In General 19
IV.15.(b). Sales Factor: Denominator 21
IV.15.(c). Sales Factor: Numerator 21
IV.16.(a). Sales Factor: Sales of Tangible Personal Property in This State 21
IV.16.(b). Sales Factor: Sales of Tangible Personal Property to the United States Government in This State 23
IV.17. Sales Factor: Sales Other Than Sales of Tangible Personal Property In This State 23
IV.18.(a). Special Rules: In General 25
IV.18.(b). Special Rules: Property Factor 26
IV.18.(c). Special Rules: Sales Factor 26

Special Industry Rules: IV.18.

(d) Construction Contractors 29
(e) Airlines....40
(f) Railroads....46
(g) Trucking Companies 50
(h) Television and Radio Broadcasting 54
(i) [Reserved] 59
(j) Publishing....60

Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions 65
Section 1: Apportionment and Allocation....65
Section 2: Definitions 66
Section 3: Receipts Factor 69
Section 4: Property Factor....75
Section 5: Payroll Factor 79
Appendix A: Definition of Financial Institution 81

MODEL STATUTES AND REGULATIONS

Uniform Protest Statute 84

ABA Model S Corporation Income Tax Act 86
Six Proposed Modifications....94

Uniform Principles Governing State Transactional Taxation of Telecommunications
Vendee Version....99
Vendor Version....105

Model Recordkeeping and Retention Regulation....111

Model Direct Payment Permit Regulation 122

Provision for the Collection of Tax on Fundraising Transactions....127

MODEL POLICY STATEMENTS AND GUIDELINES

Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272 130
Addendum: Public Law 86-272 139

Applicability of Sales and/or Use Tax to Sales of Computer Software 141

THE MULTISTATE TAX COMPACT

Article I: Purposes....144
Article II: Definitions....144
Article III: Elements of Income Tax Laws....145
Article IV: Division of Income 146
Article V: Elements of Sales and Use Tax Laws 150
Article VI: The Commission 150
Article VII: Uniform Regulations and Forms....154
Article VIII: Interstate Audits....154
Article XIX: Arbitration 155
Article X: Entry into Force and Withdrawal....157
Article XI: Effect on Other Laws and Jurisdictions 157
Article XII: Construction and Severability 158

PRESERVING FEDERALISM AND TAX FAIRNESS
THROUGH VOLUNTARY STATE TAX UNIFORMITY
by Dan R. Bucks, Executive Director

"Promot[ing] uniformity or compatibility in significant components of tax systems" is an explicitly-stated, core purpose of the Multistate Tax Compact. However, the development and adoption by the Compact Member States of model statutes, regulations, and policy guidelines is an important means of achieving the *other three* stated purposes of the Compact as well:

- "Facilitat[ing] proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes"

- "Facilitat[ing] taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration" and

- "Avoid[ing] duplicative taxation."

From the first 8 States that entered into the Multistate Tax Compact on August 4, 1967, participation in the Commission has now grown to 45 States (including the District of Columbia). There are 21 Members of the Multistate Tax Compact, 3 Sovereignty Members, 18 Associate Members, and 3 Project Members. This publication represents the concrete product of their efforts, over the course of three decades, to devise fair and administrable rules to assist taxpayers in complying with state taxation of their interstate activities.

Fulfilling the Commission's Purposes

A major focus of the Commission's uniformity work throughout its 30 year history has been the development of business income tax allocation and apportionment regulations. Indeed, the Commission has developed the authoritative body of regulations on this subject. Like most tax statutes, the Uniform Division of Income for Tax Purposes Act (UDITPA, which is embodied in Article IV of the Compact), provides only a broad framework. Extensive regulations are essential to the effective application of UDITPA to the complex and widely varying operations

of business taxpayers. Accordingly, development of generalized allocation and apportionment regulations under Article IV was one of the first major initiatives undertaken by the MTC. The Commission issued the first such regulations in 1971 and revised them significantly in 1973.

During most of the 1980s and 1990s, the MTC's uniformity work has focused on the development of special apportionment regulations for service industries that a State could adopt under authority of Section 18 of Article IV of the Compact or by statute. (Section 18 authorizes tax agencies to require "the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income" when the general UDITPA provisions "do not fairly represent the extent of the taxpayer's business activity in [a] State.") The Commission has recommended special apportionment rules for interstate trucking, railroads, airlines, construction contractors, television and radio broadcasters, publishers and, most recently, financial institutions. By providing substantially greater detail than does UDITPA, the Commission's recommended apportionment and allocation regulations help to "facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases. . . ." This is especially true with respect to the service industries that at the time of UDITPA's adoption constituted a much smaller share of our nation's economic base and were given rather cursory treatment in the statute itself.

If the recommended allocation and apportionment regulations were universally adopted, the possibility of "duplicative taxation" would be substantially eliminated (fulfilling the fourth stated purpose of the Compact). The regulations are intended to remove ambiguity and ensure that all of a business' property, payroll, and sales are assigned to the numerator of one—and only one—State's apportionment factor. The potential for overlapping taxation will be reduced even further once the Commission completes two additional income/franchise tax uniformity projects now in progress. One project is aimed at developing amendments to the general allocation and apportionment regulations that will clarify the classification of an income item as business income or non-business income. Widespread adoption by the States of clearer rules on this subject would minimize the potential for an income item to be allocated in its entirety to a business' domiciliary state and also apportioned in part to additional States because of an audit-based disagreement with the classification originally reported by the taxpayer. The second, related project is aimed at developing a more detailed and administrable definition of a unitary

business. Widespread adoption of such a definition would reduce the potential for duplicative taxation by minimizing divergent identification by States of the unitary group for combined reporting purposes and inconsistent state classification of income as business or non-business due to the composition of the unitary business.

"Facilitat[ing] taxpayer convenience and compliance" is another important goal of increased state tax uniformity. If tax laws and regulations are substantially uniform, the burdens imposed upon businesses of tracking different state rules over time, of maintaining separate spreadsheets, work papers, and supporting records to reflect these different rules, and of completing base and apportionment factor calculations may be significantly lessened.

Uniformity in Law and Joint Administrative Mechanisms: A "Synergistic" Relationship

Substantial uniformity among the States in their laws and regulations also increases the effectiveness of joint state administrative and enforcement mechanisms. Joint mechanisms have a great potential to reduce costs for businesses and States alike. For example, the Commission's Joint Audit Program has demonstrated that joint auditing is more cost-effective than single-state auditing, typically requiring about half of the auditor hours of an equivalent number of individual state audits. And while no taxpayer welcomes an audit, being audited by one auditor on behalf of several States at once is less disruptive and requires less staff time to respond to auditor requests than would an equal number of individual state audits.

In addition, joint enforcement and administrative mechanisms can themselves contribute to uniformity where it ultimately matters most: at the individual taxpayer level. The Commission's Joint Audit Program is a case in point: joint auditing encourages consistent treatment among the States in situations in which the laws and regulations are largely congruent but significant judgment is nonetheless involved in applying the rules to complex fact situations. For example, unless state rules are truly inconsistent, an auditor conducting a joint audit will not make inconsistent determinations regarding the composition of a unitary group for combined reporting purposes or the identification of business and non-business income. In contrast, inconsistent treatment of these matters can easily result when individual States conduct their own audits and make their own determinations. (Inconsistent treatment in these circumstances can, of course, lead

to duplicative taxation.)

To the extent permitted by the governing law of States participating in a joint audit, the Multistate Tax Commission works to ensure that adjustments made in joint audits do not result in overlapping taxation. Potential issues of duplicative taxation arising from Commission joint audits are referred to the MTC Audit or Uniformity Committees for resolution in consultation with the taxpayer. These issues may also be resolved through informal discussions prior to referral to an MTC committee. For example, after a joint audit determined that a manufacturer had corporate income tax nexus in several states in which it had not filed a return, the Commission conferred with the Member State from which the goods were shipped and obtained its agreement to adjust its sales factor to eliminate throwback sales from the States with corporate income tax nexus.

Joint auditing also facilitates consistent audit treatment among the participating States when laws and regulations are uniformly ambiguous or silent. For example, a Joint Audit Program audit of an interstate service-sector company led to agreement among a large number of States on an appropriate, uniform approach, for sales factor purposes, of attributing receipts from this particular type of interstate service.

Finally, joint auditing often identifies areas of non-uniformity or ambiguity in state tax laws and regulations that may be deserving of attention from policy-makers. Joint auditing may also highlight for some of the participating States a superior approach to a policy or audit issue taken by another participating State. A number of productive Commission efforts to develop model laws and regulations were initiated after joint audits revealed that the existing rules of the States in the audit were wanting.

In sum, the relationship between uniform laws and regulations and joint tax administrative mechanisms is a "synergistic" one. Greater uniformity among the States in their laws and regulations facilitates the creation of and participation in joint tax administrative mechanisms like the Commission's Joint Audit and National Nexus Programs. These, in turn, are an effective means of achieving the ultimate goal of interstate uniformity: consistent and fair treatment at the individual taxpayer level. And in some situations, joint administration or enforcement has identified significant policy matters for which a uniform law or regulation was seen as desirable and was, in fact, adopted by the Commission.

Voluntary Uniformity Reconciles Federalism and Interstate Commerce

The Commission's model regulations, statutes, and guidelines published on the following pages are, as the subtitle of the report indicates, no more than "Uniformity *Recommendations* to the States." No State, not even a Compact Member State, is bound by the Commission's adoption of a uniformity proposal. If a State voluntarily chooses to adopt an MTC model regulation, it must do so through its normal adoption procedures. Moreover, depending upon the structure of a state's laws, adoption of some MTC uniformity recommendations may require action by the state legislature.

The Multistate Tax Commission respectfully urges all state revenue agency and legislative officials with tax policy responsibility—in MTC Member and non-member States alike—to familiarize themselves with its uniformity recommendations. The Commission requests that serious consideration be given to the feasibility and potential benefits to their States and the general taxpaying community of adopting the recommendations.

In making this request, the Multistate Tax Commission does not ask States to surrender their sovereign right to make tax policy choices appropriate to the structure of their economies or reflective of the clearly articulated preferences of their citizens. However, the Commission believes that States will often find that the difference on a particular issue between current policy and the policy reflected in these recommendations is of relatively little consequence from either a fundamental fairness or revenue perspective. Policymakers need to be sensitive to the fact that even minor policy differences, or, worse, non-uniform wording that reflects no policy differences among the States at all, nonetheless can impose burdens on multistate businesses who must identify and interpret non-uniform regulations and then track them on a continuous basis.

In an increasingly competitive international economy, U.S. businesses are understandably displaying frustration with unnecessary government regulatory burdens of all kinds. This increasingly manifests itself in legislation introduced in every session of Congress to preempt some aspect of state taxation. This drama is starting to be played out in the context of international trade as well, where the recently-concluded Uruguay Round of GATT has imposed

some rules on the United States and its constituent States that a only a few years ago would have been unthinkable. The Commission Member States are committed to working actively and voluntarily to achieve greater uniformity so that the democratic principle of lodging accountability for state revenue-raising decisions and state spending decisions in the same governmental body may be preserved. Two hundred years of successfully managing a country as large and diverse as the United States through federalism—a successful compromise between one centralized, governmental solution to all problems and a totally decentralized governmental solution—is not something to be lightly thrown away or lost through inattention. Working together to achieve voluntary uniformity in the taxation of national and global commerce is a successful formula for preserving state sovereignty, and it is a formula that States can and should employ as the global economy becomes ever more integrated.

An Invitation to the Business Community and the Public

The Multistate Tax Commission welcomes the active participation of the business community and the public in its uniformity efforts. States are much more likely to move toward more uniform tax policies, laws, and rules if business and other interested groups support such changes. If the majority of the business community wants greater state tax uniformity, that majority needs to be heard throughout the process of the Commission's development of uniform proposals and the States' consideration of the Commission's recommendations.

Achieving greater interstate uniformity in the taxation of interstate and international commerce is not an end in itself. It can, however, make an important contribution toward a goal that all citizens should share: having a tax system that

- is fair and administrable;
- requires a minimum of resources for government enforcement and taxpayer compliance;
- clearly tells taxpayers what they need to know to comply with the law;
- minimizes the potential for duplicative taxation; and

- ensures that all businesses compete on a level playing field.

The Multistate Tax Commission invites tax officials and taxpayers alike to consider whether the model regulations, statutes, and guidelines published in this report can contribute to these goals. To the extent that they fall short, we invite you to work with us to improve them. Please feel free to contact the Commission if you have observations or suggestions regarding any of its uniformity recommendations or current uniformity projects. We welcome your input.

Multistate Tax Commission
Allocation and Apportionment Regulations

Adopted February 21, 1973; as revised through August 8, 1997

(Applicable to Article IV of the Multistate Tax Compact and to the Uniform Division of Income for Tax Purposes Act.)

The following revised regulations were adopted by the Multistate Tax Commission on February 21, 1973. Reg. IV.11.(a) and (b) were revised on July 14, 1988. Reg. IV.18.(c).4. was added on August 8, 1997. Special Industry Rules have been adopted and added to these Regulations (and further amended, where noted) as follows:

Reg. IV.18.(d).	Construction Contractors, July 10, 1980
Reg. IV.18.(e).	Airlines, July 14, 1983
Reg. IV.18.(f).	Railroads, July 16, 1981
Reg. IV.18.(g).	Trucking Companies, July 11, 1986; amended July 27, 1989.
Reg. IV.18.(h).	Television and Radio Broadcasting, August 31, 1990; amended April 25, 1996.
Reg. IV.18.(i).	(Reserved)
Reg. IV.18.(j).	Publishing, July 30, 1993

They are subject to adoption by each member state in accordance with its own laws and procedures.

The numerical references of the regulations are to Article IV of the Multistate Tax Compact and its subsections.

Prologue. These Regulations are intended to set forth rules concerning the application of the apportionment and allocation provisions of Article IV of the Multistate Tax Compact. The apportionment rules set forth in these Regulations are applicable to any taxpayer having business income, regardless of whether or not it has nonbusiness income, and the allocation rules set forth in these Regulations are applicable to any taxpayer having nonbusiness income, regardless of whether or not it has business income.

The only exceptions to these allocation and apportionment rules contained in these Regulations are those set forth in Regulation IV.18 pursuant to the authority of Article IV.18 of the Compact.

These Regulations are not intended to modify existing rules concerning jurisdictional standards.

••• Reg. IV.1.(a). Business and Nonbusiness Income Defined. Article IV.1.(a) defines "business income" as income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of Article IV, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income.

Nonbusiness income means all income other than business income.

The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is of no aid in determining whether income is business or non-business income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business. In general all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business. (See Regulation IV.1.(c) for more specific examples of the classification of income as business or nonbusiness income; see Regulation IV.1.(b) and IV.2.(b)(2) for further explanation of what constitutes a trade or business.)

••• Reg. IV.1.(b). Two or More Businesses of a Single Taxpayer. A taxpayer may have more than one "trade or business." In such cases, it is necessary to determine the business income attributable to each separate trade or business. The income of each business is then apportioned by an apportionment formula which takes into consideration the instate and outstate factors which relate to the trade or business the income of which is being apportioned.

Example: The taxpayer is a conglomerate with three operating divisions. One division is engaged in manufacturing aerospace items for the federal government. Another division is engaged in growing tobacco products. The third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this state as well as in other states. In this case, it is fair to conclude that the taxpayer is engaged in three separate "trades or businesses." Accordingly, the amount of business income attributable to the taxpayer's trade or business activities in this state is determined by applying an appropriate apportionment formula to the business income of each business.

Single trade or business. The determination of whether the activities of the taxpayer

constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business, and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

(1) Same type of business. A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

(2) Steps in a vertical process. A taxpayer is almost always engaged in a single trade or business when its various divisions or segments are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the taxpayer's executive offices.

(3) Strong centralized management. A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing.

••• Reg. IV.1.(c). Business and Nonbusiness Income: Application of Definitions. The following are rules and examples for determining whether particular income is business or nonbusiness income. (The examples used throughout these regulations are illustrative only and do not purport to set forth all pertinent facts.)

(1) Rents from real and tangible personal property. Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business or incidental thereto and therefore is includable in the property factor under Regulation IV.10.

Example (i): The taxpayer operates a multistate car rental business. The income

from car rentals is business income.

Example (ii): The taxpayer is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earth-moving vehicles. The taxpayer makes short-term leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is business income.

Example (iii): The taxpayer operates a multistate chain of men's clothing stores. The taxpayer purchases a five-story office building for use in connection with its trade or business. It uses the street floor as one of its retail stores and the second and third floors for its general corporate headquarters. The remaining two floors are leased to others. The rental of the two floors is incidental to the operation of the taxpayer's trade or business. The rental income is business income.

Example (iv): The taxpayer operates a multistate chain of grocery stores. It purchases as an investment an office building in another state with surplus funds and leases the entire building to others. The net rental income is not business income of the grocery store trade or business. Therefore, the net rental income is nonbusiness income.

Example (v): The taxpayer operates a multistate chain of men's clothing stores. The taxpayer invests in a 20-story office building and uses the street floor as one of its retail stores and the second floor for its general corporate headquarters. The remaining 18 floors are leased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. The net rental income is not business income of the clothing store trade or business. Therefore, the net rental income is nonbusiness income.

Example (vi): The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed by the taxpayer until it was sold 18 months later. The rental income is business income and the gain on the sale of the plant is business income.

Example (vii): The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The net rental income received over the lease period is nonbusiness income and the gain (or loss) on the sale of the building is nonbusiness income.

(2) Gains or losses from sales of assets. Gain or loss from the sale, exchange or other disposition of real property or of tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business.

However, if the property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income. See Regulation IV.10.

Example (i): In conducting its multistate manufacturing business, the taxpayer systematically replaces automobiles, machines, and other equipment used in the business. The gains or losses resulting from those sales constitute business income.

Example (ii): The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later sold the property at a gain while it was in operation by the taxpayer. The gain is business income.

Example (iii): Same as (ii) except that the plant was closed and put up for sale but was not in fact sold until a buyer was found 18 months later. The gain is business income.

Example (iv): Same as (ii) except that the plant was rented while being held for sale. The rental income is business income and the gain on the sale of the plant is business income.

Example (v): The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an unrelated investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The gain (or loss) on the sale is nonbusiness income and the rental income received over the lease period is nonbusiness income.

(3) Interest. Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.

Example (i): The taxpayer operates a multistate chain of department stores, selling for cash and on credit. Service charges, interest, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are business income.

Example (ii): The taxpayer conducts a multistate manufacturing business. During the year the taxpayer receives a federal income tax refund and collects a judgment against a debtor of the business. Both the tax refund and the judgment bear interest. The interest income is business income.

Example (iii): The taxpayer is engaged in a multistate manufacturing and

wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, rain and storm damage, machinery replacement, etc. The moneys in those accounts are invested at interest. Similarly, the taxpayer temporarily invests funds intended for payment of federal, state and local tax obligations. The interest income is business income.

Example (iv): The taxpayer is engaged in a multistate money order and traveler's check business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The interest income is business income.

Example (v): The taxpayer is engaged in a multistate manufacturing and selling business. The taxpayer usually has working capital and extra cash totaling $200,000 which it regularly invests in short-term interest bearing securities. The interest income is business income.

Example (vi): In January, the taxpayer sold all of the stock of a subsidiary for $20,000,000. The funds are placed in an interest-bearing account pending a decision by management as to how the funds are to be utilized. The interest income is nonbusiness income.

(4) Dividends. Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose of acquiring and holding the stock is related to or incidental to such trade or business operations.

Example (i): The taxpayer operates a multistate chain of stock brokerage houses. During the year, the taxpayer receives dividends on stock that it owns. The dividends are business income.

Example (ii): The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A portion of the moneys in those accounts is invested in interest-bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business income.

Example (iii): The taxpayer and several unrelated corporations own all of the stock of a corporation whose business operations consist solely of acquiring and processing materials for delivery to the corporate owners. The taxpayer acquired the stock in order to obtain a source of supply of materials used in its manufacturing business. The dividends are business income.

Example (iv): The taxpayer is engaged in a multistate heavy construction business.

Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity the taxpayer holds various stocks and interest-bearing securities. Both the interest income and any dividends received are business income.

Example (v): The taxpayer receives dividends from the stock of its subsidiary or affiliate which acts as the marketing agency for products manufactured by the taxpayer. The dividends are business income.

Example (vi): The taxpayer is engaged in a multistate glass manufacturing business. It also holds a portfolio of stock and interest-bearing securities, the acquisition and holding of which are unrelated to the manufacturing business. The dividends and interest income received are nonbusiness income.

(5) Patent and copyright royalties. Patent and copyright royalties are business income where the patent or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the patent or copyright is related to or incidental to such trade or business operations.

Example (i): The taxpayer is engaged in the multistate business of manufacturing and selling industrial chemicals. In connection with that business, the taxpayer obtained patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries, in return for which the taxpayer receives royalties. The royalties received by the taxpayer are business income.

Example (ii): The taxpayer is engaged in the music publishing business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. These acquired copyrights are thereafter used by the taxpayer in its business. Any royalties received on these copyrights are business income.

Example (iii): Same as example (ii), except that the acquired company also held the patent on a type of phonograph needle. The taxpayer does not manufacture or sell phonographs or phonograph equipment. Any royalties received on the patent would be nonbusiness income.

••• Reg. IV.1.(d). Proration of Deductions. In most cases, an allowable deduction of a taxpayer will be applicable to only the business income arising from a particular trade or business or to a particular item of nonbusiness income. In some cases, an allowable deduction may be applicable to the business incomes of more than one trade or business and/or to several items of

nonbusiness income. In such cases, the deduction shall be prorated among those trades or businesses and those items of nonbusiness income in a manner which fairly distributes the deduction among the classes of income to which it is applicable.

(1) Year to year consistency. In filing returns with this state, if the taxpayer departs from or modifies the manner of prorating any such deduction used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) State to state consistency. If the returns or reports filed by a taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the application or proration of any deduction, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• Reg. IV.2.(a). Definitions.

(1) "Taxpayer" means [each state should insert the definition in Article II.3. or the definition in its own tax laws].

(2) "Apportionment" refers to the division of business income between states by the use of a formula containing apportionment factors.

(3) "Allocation" refers to the assignment of nonbusiness income to a particular state.

(4) "Business activity" refers to the transactions and activity occurring in the regular course of a particular trade or business of a taxpayer.

••• Reg. IV.2.(b)(1). Application of Article IV: Apportionment. If the business activity in respect to any trade or business of a taxpayer occurs both within and without this state, and if by reason of such business activity the taxpayer is taxable in another state, the portion of the net income (or net loss) arising from such trade or business which is derived from sources within this state shall be determined by apportionment in accordance with Article IV.9. to IV.17.

••• Reg. IV.2.(b)(2). Application of Article IV: Combined Report. If a particular trade or business is carried on by a taxpayer and one or more affiliated corporations, nothing in Article IV or in these regulations shall preclude the use of a "combined report" whereby the entire business income of such trade or business is apportioned in accordance with Article IV.9. to IV.17.

••• Reg. IV.2.(b)(3). Application of Article IV: Allocation. Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of its nonbusiness income or loss within or without this state in accordance with Article IV.4. to IV.8.

••• Reg. IV.2.(c). Consistency and Uniformity in Reporting.

(1) Year to year consistency. In filing returns with this state, if the taxpayer departs from or modifies the manner in which income has been classified as business income or nonbusiness income in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) State to state consistency. If the returns or reports filed by a taxpayer for all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the classification of income as business or nonbusiness income, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• Reg. IV.3.(a). Taxable in Another State: In General. Under Article IV.2. the taxpayer is subject to the allocation and apportionment provisions of Article IV if it has income from business activity that is taxable both within and without this state. A taxpayer's income from business activity is taxable without this state if the taxpayer, by reason of such business activity (i.e., the transactions and activity occurring in the regular course of a particular trade or business), is taxable in another state within the meaning of Article IV.3.

(1) Applicable tests. A taxpayer is taxable within another state if it meets either one of two tests: (1) By reason of business activity in another state, the taxpayer is subject to one of the types of taxes specified in Article IV.3.(1), namely: A net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) By reason of such business activity, another state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether or not the state imposes such a tax on the taxpayer.

(2) Producing nonbusiness income. A taxpayer is not taxable in another state with respect to a particular trade or business merely because the taxpayer conducts activities in that other state pertaining to the production of nonbusiness income or business activities relating to a separate trade or business.

••• Reg. IV.3.(b).Taxable in Another State: When a Corporation Is "Subject to" a Tax under Article IV.3.(1).

(1) A taxpayer is "subject to" one of the taxes specified in Article IV.3.(1) if it carries on business activities in a state and the state imposes such a tax thereon. Any taxpayer which asserts that it is subject to one of the taxes specified in Article IV.3.(1) in another state shall furnish to the [tax administrator] of this state upon his/her request evidence to support that assertion. The [tax administrator] of this state may request that such evidence include proof that the taxpayer has filed the requisite tax return in the other state and has paid any taxes imposed under the law of the other state; the taxpayer's failure to produce such proof may be taken into account in determining whether the taxpayer in fact is subject to one of the taxes specified in Article IV.3.(1) in the other state.

Voluntary tax payment. If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but

(A) does not actually engage in business activity in that state, or

(B) does actually engage in some business activity not sufficient for nexus and the minimum tax bears no relationship to the taxpayer's business activity within such state, the taxpayer is not "subject to" one of the taxes specified within the meaning of Article IV.3.(1).

Example: State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return and pays the $50 minimum tax, although it carries on no business activity in State A. Corporation X is not taxable in State A.

(2) The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activity may impose an income tax even though every state does not do so. In states which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes enumerated in Article IV.3.(1) which may be considered as basically revenue raising rather than regulatory measures shall be considered in determining whether the taxpayer is "subject to" one of the taxes specified in Article IV.3.(1) in another state.

Example (i): State A requires all nonresident corporations which qualify or register in State A to pay to the Secretary of State an annual license fee or tax for the privilege of doing business in the state regardless of whether the privilege is in fact exercised. The amount paid is determined according to the total authorized capital stock of the corporation; the rates are progressively higher by bracketed amounts. The statute sets a minimum fee of $50 and a maximum fee of $500. Failure to pay the tax bars a corporation from utilizing the state courts for enforcement of its rights. State A also imposes a corporation income tax. Nonresident Corporation X is qualified in State A and pays the required fee to the Secretary of State but does not carry on any business activity in State A (although it may utilize the courts of State A). Corporation X is not "taxable" in State A.

Example (ii): Same facts as Example (i) except that Corporation X is subject to and pays the corporation income tax. Payment is prima facie evidence that Corporation X is "subject to" the net income tax of State A and is "taxable" in State A.

Example (iii): State B requires all nonresident corporations qualified or registered in State B to pay to the Secretary of State an annual permit fee or tax for doing business in the state. The base of the fee or tax is the sum of (1) outstanding capital stock, and (2) surplus and undivided profits. The fee or tax base attributable to State B is determined by a three factor apportionment formula. Nonresident Corporation X which operates a plant

in State B, pays the required fee or tax to the Secretary of State. Corporation X is "taxable" in State B.

Example (iv): State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return based upon its business activity in the state but the amount of computed liability is less than the minimum tax. Corporation X pays the minimum tax. Corporation X is subject to State A's corporation franchise tax.

••• Reg. IV.3.(c). Taxable in Another State: When a State Has Jurisdiction to Subject a Taxpayer to a Net Income Tax. The second test, that of Article IV.3.(2), applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. §§ 381-385. In the case of any "state" as defined in Article IV.1.(h), other than a state of the United States or political subdivision thereof, the determination of whether the "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that "state." If jurisdiction is otherwise present, that "state" is not considered as being without jurisdiction by reason of the provisions of a treaty between that "state" and the United States.

Example: Corporation X is actively engaged in manufacturing farm equipment in State A and in foreign country B. Both State A and foreign country B impose a net income tax but foreign country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of State A and foreign country B.

••• Reg. IV.9. Apportionment Formula. All business income of each trade or business of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in Article IV.9. The elements of the apportionment formula are the property factor (see Regulation IV.10.), the payroll factor (see Regulation IV.13.) and the sales factor (see Regulation IV.15.) of the trade or business of the taxpayer.

••• Reg. IV.10.(a). Property Factor: In General. The property factor of the apportionment formula for each trade or business of the taxpayer shall include all real and tangible personal property owned or rented by the taxpayer and used during the tax period in the regular course of the trade or business. The term "real and tangible personal property" includes land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency. Property used in connection with the production of nonbusiness income shall be excluded from the property factor. Property used both in the regular course of the taxpayer's trade or business and in the production of nonbusiness income shall be included in the factor only to the extent that the property is used in the regular course of the taxpayer's trade or business. The method of determining that portion of the value to be included in the factor will depend upon the facts of each case. The property factor shall include the average value of

property includable in the factor. See Regulation IV.12.

••• Reg. IV.10.(b). Property Factor: Property Used for the Production of Business Income. Property shall be included in the property factor if it is actually used or is available for or capable of being used during the tax period in the regular course of the trade or business of the taxpayer. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period (except inventoriable goods in process) shall be excluded from the factor until such property is actually used in the regular course of the trade or business of the taxpayer. If the property is partially used in the regular course of the trade or business of the taxpayer while under construction, the value of the property to the extent used shall be included in the property factor. Property used in the regular course of the trade or business of the taxpayer shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its conversion to the production of nonbusiness income, its sale, or the lapse of an extended period of time (normally, five years) during which the property is held for sale.

Example (i): Taxpayer closed its manufacturing plant in State X and held the property for sale. The property remained vacant until its sale one year later. The value of the manufacturing plant is included in the property factor until the plant is sold.

Example (ii): Same as above except that the property was rented until the plant was sold. The plant is included in the property factor until the plant is sold.

Example (iii): Taxpayer closed its manufacturing plant and leased the building under a five-year lease. The plant is included in the property factor until the commencement of the lease.

Example (iv): The taxpayer operates a chain of retail grocery stores. Taxpayer closed Store A, which was then remodeled into three small retail stores such as a dress shop, dry cleaning, and barber shop, which were leased to unrelated parties. The property is removed from the property factor on the date on which the remodeling of Store A commenced.

••• Reg. IV.10.(c). Property Factor: Consistency in Reporting.

(1) Year to year consistency. In filing returns with this state, if the taxpayer departs from or modifies the manner of valuing property or of excluding property from or including property in the property factor used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) State to state consistency. If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the valuation of property and in the exclusion of property from or the inclusion of property in the property factor, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• Reg. IV.10.(d). Property Factor: Numerator. The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period in the regular course of the trade or business of the taxpayer. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located within and without this state during the tax period shall be determined for purposes of the numerator of the factor on the basis of total time within the state during the tax period. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

••• Reg. IV.11.(a). Property Factor: Valuation of Owned Property.

(1) Property owned by the taxpayer shall be valued at its original cost. As a general rule, "original cost" is deemed to be the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc. However, capitalized intangible drilling and development costs shall be included in the property factor whether or not they have been expensed for either federal or state tax purposes. [This last sentence was added on July 14, 1988.]

Example (i): The taxpayer acquired a factory building in this state at a cost of $500,000 and, 18 months later, expended $100,000 for major remodeling of the building. Taxpayer files its return for the current taxable year on the calendar-year basis. Depreciation deduction in the amount of $22,000 was claimed with respect to the building on the return for the current taxable year. The value of the building includable in the numerator and denominator of the property factor is $600,000; the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

Example (ii): During the current taxable year, Corporation X merges into Corporation Y in a tax-free reorganization under the Internal Revenue Code. At the time of the merger, Corporation X owns a factory which X built five years earlier at a cost of $1,000,000. X has been depreciating the factory at the rate of two percent per year, and its basis in X's hands at the time of the merger is $900,000. Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, its basis in Y's hands is the same as its basis in X's hands, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, i.e. $1,000,000.

Example (iii): Corporation Y acquires the assets of Corporation X in a liquidation by which Y is entitled to use its stock cost as the basis of the X assets under Section 334(b)(2) of the 1954 Internal Revenue Code (i.e. stock possessing 80 percent control is purchased and liquidated within two years). Under these circumstances, Y's cost of the assets is the purchase price of the X stock, prorated over the X assets.

If the original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

(2) Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.

(3) Property acquired by gift or inheritance shall be included in the factor at its basis for determining depreciation for federal income tax purposes.

••• Reg. IV.11.(b). Property Factor: Valuation of Rented Property.

(1) Multiplier and subrentals. Property rented by the taxpayer is valued at eight times its net annual rental rate. The net annual rental rate for any item of rented property is the annual rental rate paid by the taxpayer for the property less the aggregate annual subrental rates paid by subtenants of the taxpayer. (See Regulation IV.18.(a) for special rules when the use of such net annual rental rate produces a negative or clearly inaccurate value or when property is used by the taxpayer at no charge or is rented at a nominal rental rate.)

Subrents are not deducted when they constitute business income because the property which produces the subrents is used in the regular course of a trade or business of the taxpayer when it is producing such income. Accordingly there is no reduction in its value.

Example (i): The taxpayer receives subrents from a bakery concession in a food market operated by the taxpayer. Since the subrents are business income, they are not deducted from rent paid by the taxpayer for the food market.

Example (ii): The taxpayer rents a 5-story office building primarily for use in its multistate business, uses three floors for its offices and subleases two floors to various other businesses and persons such as professional people and shops. The rental of the two floors is incidental to the operation of the taxpayer's trade or business. Since the subrents are business income, they are not deducted from the rent paid by the taxpayer.

Example (iii): The taxpayer rents a 20-story office building and uses the lower two stories for its general corporation headquarters. The remaining 18 floors are subleased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. Since the subrents are nonbusiness income they are to be deducted from the rent paid by the taxpayer.

(2) "Annual rental rate" is the amount paid as rental for property for a 12-month period (i.e., the amount of the annual rent). Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of 12 or more months and the current tax period covers a period of less than 12 months (due, for example, to a reorganization or change of accounting period), the rent paid for the short tax period shall be annualized. If the rental term is for less than 12 months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month-to-month basis.

Example (i): Taxpayer A, which ordinarily files its returns based on a calendar year, is merged into Taxpayer B on April 30. The net rent paid under a lease with 5 years remaining is $2,500 a month. The rent for the tax period January 1 to April 30 is $10,000. After the rent is annualized the net rent is $30,000 ($2,500 x 12).

Example (ii): Same facts as in Example (i) except that the lease would have terminated on August 31. In this case, the annualized rent is $20,000 ($2,500 x 8).

(3) "Annual rent" is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

(A) Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

Example: A taxpayer, pursuant to the terms of a lease, pays a lessor $1,000 per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of $400,000. The annual rent is $16,000 ($12,000 plus one percent of $400,000 or $4,000).

(B) Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and other items.

Example (i): A taxpayer, pursuant to the terms of a lease, pays the lessor $12,000 a year rent plus taxes in the amount of $2,000 and interest on a mortgage in the amount of $1,000. The annual rent is $15,000.

Example (ii): A taxpayer stores part of its inventory in a public warehouse. The total charge for the year was $1,000 of which $700 was for the use of storage space and $300 for inventory insurance, handling and shipping charges, and C.O.D. collections. The annual rent is $700.

(4) Exclusions. "Annual rent" does not include:

(A) Incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, etc.; and

(B) Royalties based on extraction of natural resources, whether represented by delivery or purchase. For this purpose, a royalty includes any consideration conveyed or credited to a holder of an interest in property which constitutes a sharing of current or future production of natural resources from such property, irrespective of the method of payment or how such consideration may be characterized, whether as a royalty, advance royalty, rental or otherwise. [This provision was added on July 14, 1988.]

(5) Leasehold improvements shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the factor.

••• Reg. IV.12. Property Factor: Averaging Property Values. As a general rule, the average value of property owned by the taxpayer shall be determined by averaging the values at the beginning and ending of the tax period. However, the [tax administrator] may require or allow averaging by monthly values if that method of averaging is required to properly reflect the average value of the taxpayer's property for the tax period.

Averaging by monthly values will generally be applied if substantial fluctuations in the values of the property exist during the tax period or if property is acquired after the beginning of the tax period or disposed of before the end of the tax period.

Example: The monthly value of the taxpayer's property was as follows:

January	$2,000	July	$15,000
February	2,000	August	17,000
March	3,000	September	23,000
April	3,500	October	25,000
May	4,500	November	13,000
June	10,000	December	2,000
	$25,000		$95,000
		Total	$120,000

The average value of the taxpayer's property includable in the property factor for the income year is determined as follows:

$$\frac{\$120,000}{12} = \$10,000$$

Averaging with respect to rented property is achieved automatically by the method of determining the net annual rental rate of such property as set forth in Reg. IV.11.(b).

••• Reg. IV.13.(a). Payroll Factor: In General.

(1) The payroll factor of the apportionment formula for each trade or business of the taxpayer shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax period.

(2) The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, compensation paid to employees may, at the election of the taxpayer, be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under that method for unemployment compensation purposes.

The compensation of any employee on account of activities which are connected with the production of nonbusiness income shall be excluded from the factor.

Example (i): The taxpayer uses some of its employees in the construction of a storage building which, upon completion, is used in the regular course of the taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of those wages is included in the payroll factor.

Example (ii): The taxpayer owns various securities which it holds as an investment separate and apart from its trade or business. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

(3) The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered paid directly include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the federal Internal Revenue Code. In the case of employees not subject to the federal Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the federal Internal Revenue Code.

(4) The term "employee" means (A) any officer of a corporation, or (B) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common-law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this regulation.

(5) Year to year consistency. In filing returns with this state, if the taxpayer departs from or modifies the treatment of compensation paid used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(6) State to state consistency. If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the treatment of compensation paid, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• Reg. IV.13.(b). Payroll Factor: Denominator. The denominator of the payroll factor is the total compensation paid everywhere during the tax period. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is immune from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

Example: A taxpayer has employees in its state of legal domicile (State A) and is taxable in State B. In addition the taxpayer has other employees whose services are performed entirely in State C where the taxpayer is immune from taxation under the provisions of Public Law 86-272. As to these latter employees, the compensation will be assigned to State C where their services are performed (i.e., included in the denominator but not the numerator of the payroll factor) even though the taxpayer is not taxable in State C.

••• Reg. IV.13.(c). Payroll Factor: Numerator. The numerator of the payroll factor is the total amount paid in this state during the tax period by the taxpayer for compensation. The tests in Article IV.14. to be applied in determining whether compensation is paid in this state are derived from the Model Unemployment Compensation Act. Accordingly, if compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under that method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this state for unemployment compensation purposes constitute compensation paid in this state except for compensation excluded under Regulation IV.13.(a). to IV.14. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to this state for unemployment compensation purposes.

••• Reg. IV.14. Payroll Factor: Compensation Paid in This State. Compensation is paid in this state if any one of the following tests, applied consecutively, are met:

(1) The employee's service is performed entirely within the state.

(2) The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(3) If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:

(A) if the employee's base of operations is in this state; or

(B) if there is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this state; or

(C) if the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed but the employee's residence is in this state.

The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points.

••• Reg. IV.15.(a). Sales Factor: In General.

(1) Article IV.1.(g) defines the term "sales" to mean all gross receipts of the taxpayer not allocated under paragraphs (5) through (8) of Article IV. Thus, for the purposes of the sales factor of the apportionment formula for each trade or business of the taxpayer, the term "sales" means all gross receipts derived by the taxpayer from transactions and activity in the regular course of the trade or business. The following are rules for determining "sales" in various situations:

(A) In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the

taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if the taxes are passed on to the buyer or included as part of the selling price of the product.

(B) In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, "sales" includes the entire reimbursed cost plus the fee.

(C) In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency or the performance of equipment service contracts or research and development contracts, "sales" includes the gross receipts from the performance of such services, including fees, commissions, and similar items.

(D) In the case of a taxpayer engaged in renting real or tangible property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.

(E) In the case of a taxpayer engaged in the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

(F) If a taxpayer derives receipts from the sale of equipment used in its business, those receipts constitute sales. For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sales of the trucks are included in the sales factor.

(2) Exceptions. In some cases certain gross receipts should be disregarded in determining the sales factor in order that the apportionment formula will operate fairly to apportion to this state the income of the taxpayer's trade or business. See Regulation IV.18.(c).

(3) Year to year consistency. In filing returns with this state, if the taxpayer departs from or modifies the basis for excluding or including gross receipts in the sales factor used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(4) State to state consistency. If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the inclusion or exclusion of gross receipts, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• Reg. IV.15.(b). Sales Factor: Denominator. The denominator of the sales factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts excluded under Regulation IV.18.(c).

••• Reg. IV.15.(c). Sales Factor: Numerator. The numerator of the sales factor shall include gross receipts attributable to this state and derived by the taxpayer from transactions and activity in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incidental to such gross receipts shall be included regardless of (1) the place where the accounting records are maintained or (2) the location of the contract or other evidence of indebtedness.

••• Reg. IV.16.(a). Sales Factor: Sales of Tangible Personal Property in This State.

(1) Gross receipts from sales of tangible personal property (except sales to the United States Government; see Regulation IV.16.(b)) are in this state:

(A) if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale; or

(B) if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the taxpayer is not taxable in the state of the purchaser.

(2) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

Example: The taxpayer, with inventory in State A, sold $100,000 of its products to a purchaser having branch stores in several states, including this state. The order for the purchase was placed by the purchaser's central purchasing department located in State B. $25,000 of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the purchaser within this state with respect to $25,000 of the taxpayer's sales.

(3) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

Example: The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of the taxpayer's products shipped to the purchaser's warehouse in this state constitute property delivered or shipped to a purchaser within this state.

(4) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

Example: A taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the

merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is in this state.

(5) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this state, the sales are in this state.

Example: The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While en route, the produce is diverted to the purchaser's place of business in this state in which state the taxpayer is subject to tax. The sale by the taxpayer is attributed to this state.

(6) If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state.

Example: The taxpayer has its head office and factory in State A. It maintains a branch office and inventory in this state. Taxpayer's only activity in State B is the solicitation of orders by a resident salesman. All orders by the State B salesman are sent to the branch office in this state for approval and are filled by shipment from the inventory in this state. Since the taxpayer is immune under Public Law 86-272 from tax in State B, all sales of merchandise to purchasers in State B are attributed to this state, the state from which the merchandise was shipped.

(7) If a taxpayer whose salesman operates from an office located in this state makes a sale to a purchaser in another state in which the taxpayer is not taxable and the property is shipped directly by a third party to the purchaser, the following rules apply:

(A) If the taxpayer is taxable in the state from which the third party ships the property, then the sale is in that state.

(B) If the taxpayer is not taxable in the state from which the property is shipped, then the sale is in this state.

Example: The taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer is not taxable in State A. Upon direction of the taxpayer, the merchandise was shipped directly to the purchaser by the manufacturer in State B. If the taxpayer is taxable in State B, the sale is in State B. If the taxpayer is not taxable in State B, the sale is in this state.

••• Reg. IV.16.(b). Sales Factor: Sales of Tangible Personal Property to the United States Government in This State. Gross receipts from sales of tangible personal property to the United States Government are in this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. For the purposes of this regulation, only sales for

which the United States Government makes direct payment to the seller pursuant to the terms of a contract constitute sales to the United States Government. Thus, as a general rule, sales by a subcontractor to the prime contractor, the party to the contract with the United States Government, do not constitute sales to the United States Government.

Example (i): A taxpayer contracts with General Services Administration to deliver X number of trucks which were paid for by the United States Government. The sale is a sale to the United States Government.

Example (ii): The taxpayer, as a subcontractor to a prime contractor with the National Aeronautics and Space Administration, contracts to build a component of a rocket for $1,000,000. The sale by the subcontractor to the prime contractor is not a sale to the United States Government.

••• Reg. IV.17. Sales Factor: Sales Other Than Sales of Tangible Personal Property in This State

(1) In general. Article IV.17. provides for the inclusion in the numerator of the sales factor of gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government); under this section, gross receipts are attributed to this state if the income producing activity which gave rise to the receipts is performed wholly within this state. Also, gross receipts are attributed to this state if, with respect to a particular item of income, the income producing activity is performed within and without this state but the greater proportion of the income producing activity is performed in this state, based on costs of performance.

(2) Income producing activity: defined. The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, income producing activity includes but is not limited to the following:

(A) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.

(B) The sale, rental, leasing, licensing or other use of real property.

(C) The rental, leasing, licensing or other use of tangible personal property.

(D) The sale, licensing or other use of intangible personal property.

The mere holding of intangible personal property is not, of itself, an income producing activity.

(3) Costs of performance: defined. The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

(4) Application.

(A) In general. Receipts (other than from sales of tangible personal property) in respect to a particular income producing activity are in this state if:

(a) the income producing activity is performed wholly within this state; or

(b) the income producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state, based on costs of performance.

(B) Special rules. The following are special rules for determining when receipts from the income producing activities described below are in this state:

(a) Gross receipts from the sale, lease, rental or licensing of real property are in this state if the real property is located in this state.

(b) Gross receipts from the rental, lease, or licensing of tangible personal property are in this state if the property is located in this state. The rental, lease, licensing or other use of tangible personal property in this state is a separate income producing activity from the rental, lease, licensing or other use of the same property while located in another state; consequently, if property is within and without this state during the rental, lease or licensing period, gross receipts attributable to this state shall be measured by the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during that period.

Example: Taxpayer is the owner of 10 railroad cars. During the year, the total of the days during which each railroad car was present in this state was 50 days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:

$$\frac{(10 \times 50) = 500}{3650} \times \text{Total Receipts} = \text{Receipts Attributable to this State}$$

(c) Gross receipts for the performance of personal services are attributable to this state to the extent that such services are performed in this state. If services relating to a single item of income are performed partly within and partly without this state, the gross receipts from the performance of such services shall be attributable to this state only if the greater proportion of the services was performed in the state, based on costs of performance. Usually, where services are

performed partly within and partly without this state, the services performed in each state will constitute a separate income producing activity; in such cases, the gross receipts from the performance of services attributable to this state shall be measured by the ratio which the time spent in performing the services in this state bears to the total time spent in performing the services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example time expended in negotiating the contract, is excluded from the computations.

Example (i): Taxpayer, a road show, gave theatrical performances at various locations in State X and in this state during the tax period. All gross receipts from performances given in this state are attributed to this state.

Example (ii): The taxpayer, a public opinion survey corporation, conducted a poll by means of its employees in State X and in this state for the sum of $9,000. The project required 600 man-hours to obtain the basic data and prepare the survey report. Two hundred of the 600 man hours were expended in this state. The receipts attributable to this state are $3,000.

$$\frac{200}{600} \times \$9{,}000 = \$3{,}000$$

••• Reg. IV.18.(a). Special Rules: In General. Article IV.18. provides that if the allocation and apportionment provisions of Article IV do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) the exclusion of any one or more of the factors;

(3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article IV.18. permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases. Article IV.18. may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and non recurring) produce incongruous results under the apportionment and allocation provisions contained in Article IV.

In the case of certain industries such as air transportation, rail transportation, ship transportation, trucking, television, radio, motion pictures, various types of professional athletics,

and so forth, the foregoing regulations in respect to the apportionment formula do not set forth appropriate procedures for determining the apportionment factors. Nothing in Article IV.18. or in this Regulation IV.18. shall preclude [the tax administrator] from establishing appropriate procedures under Article IV.10. to 17. for determining the apportionment factors for each such industry, but such procedures shall be applied uniformly.

••• Reg. IV.18.(b). Special Rules: Property Factor. The following special rules are established in respect to the property factor of the apportionment formula:

(1) If the subrents taken into account in determining the net annual rental rate under Regulation IV.11.(b) produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the [tax administrator] or requested by the taxpayer.

In no case, however, shall the value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for the property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

Example: The taxpayer rents a 10-story building at an annual rental rate of $1,000,000. Taxpayer occupies two stories and sublets eight stories for $1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the taxpayer's annual rental rate for the entire year, or $200,000.

(2) If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for the property shall be determined on the basis of a reasonable market rental rate for the property.

••• Reg. IV.18.(c). Special Rules: Sales Factor. The following special rules are established in respect to the sales factor of the apportionment formula:

(1) Where substantial amounts of gross receipts arise from an incidental or occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, those gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.

(2) Insubstantial amounts of gross receipts arising from incidental or occasional transactions or activities may be excluded from the sales factor unless their exclusion would materially affect the amount of income apportioned to this state. For example, the taxpayer ordinarily may include in or exclude from the sales factor gross receipts from transactions such as the sale of office furniture, business automobiles, etc.

(3) Where the income producing activity in respect to business income from intangible personal property can be readily identified, the income is included in the denominator of the sales factor and, if the income producing activity occurs in this state, in the numerator of the sales

factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (Regulation IV.15.(a)(1)(A)) and income from the sale, licensing or other use of intangible personal property (Regulation IV.17.(2)(D)).

Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, the dividends and interest shall be excluded from the denominator of the sales factor.

(4) (A) Where gains and losses on the sale of liquid assets are not excluded from the sales factor by other provisions under Reg.IV.18.(c)., such gains or losses shall be treated as provided in this subsection. This subsection does not provide rules relating to the treatment of other receipts produced from holding or managing such assets. If a taxpayer holds liquid assets in connection with one or more treasury functions of the taxpayer, and the liquid assets produce business income when sold, exchanged or otherwise disposed, the overall net gain from those transactions for each treasury function for the tax period is included in the sales factor. For purposes of this subsection, each treasury function will be considered separately.

(B) For purposes of this subsection, a liquid asset is an asset (other than functional currency or funds held in bank accounts) held to provide a relatively immediate source of funds to satisfy the liquidity needs of the trade or business. Liquid assets include foreign currency (and trading positions therein) other than functional currency used in the regular course of the taxpayer's trade or business; marketable instruments (including stocks, bonds, debentures, options, warrants, futures contracts, etc.); and mutual funds which hold such liquid assets. An instrument is considered marketable if it is traded in an established stock or securities market and is regularly quoted by brokers or dealers in making a market. Stock in a corporation which is unitary with the taxpayer, or which has a substantial business relationship with the taxpayer is not considered marketable stock.

(C) For purposes of this subsection, a treasury function is the pooling and management of liquid assets for the purpose of satisfying the cash flow needs of the trade or business, such as providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, business acquisitions, etc. A taxpayer principally engaged in the trade or business of purchasing and selling instruments or other items included in the definition of liquid assets set forth herein is not performing a treasury function with respect to income so produced.

(D) Overall net gain refers to the total net gain from all transactions incurred at each treasury function for the entire tax period, not the net gain from a specific transaction.

(E) Examples.

Example (i). A taxpayer manufactures various gift items. Because of seasonal variations, the taxpayer must keep liquid assets available for later inventory acquisitions. Because the manufacturer wants to obtain a return on available funds, the manufacturer acquires liquid assets, which are held and managed in State A. The net gain resulting from all gains and losses on the sale of the liquid assets for the tax year will be reflected in the denominator of the sales factor and in the numerator of State A.

Example (ii). A stockbroker acts as a dealer or trader for its own account in its ordinary course of business. Some of the instruments sold are liquid assets. This subsection does not operate to classify those sales as attributable to a treasury function.

••• Reg.IV.18.(d). Special Regulation: Construction Contractors. [Adopted July 10, 1980]

The following special rules are established in respect to the apportionment of income of long-term construction contractors:

(1) In General. When a taxpayer elects to use the percentage of completion method of accounting, or the completed contract method of accounting for long-term contracts (construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted), and has income from sources both within and without this state from a trade or business, the amount of business income derived from such long-term contracts from sources within this state shall be determined pursuant to this regulation. In such cases, the first step is to determine which portion of the taxpayer's income constitutes "business income" and which portion constitutes "nonbusiness income" under Article IV.1 and Reg. IV.1 thereunder. Nonbusiness income is directly allocated to specific states pursuant to the provisions of Article IV.5 to .8, inclusive. Business income is apportioned among the states in which the business is conducted pursuant to the property, payroll, and sales apportionment factors set forth in this regulation. The sum of (1) the items of nonbusiness income directly allocated to this state and (2) the amount of business income attributable to this state constitutes the amount of the taxpayer's entire net income which is subject to tax by this state.

(2) Business and Nonbusiness Income. For definitions, rules and examples for determining business and nonbusiness income, see Reg. IV.1.

(3) Methods of Accounting and Year of Inclusion. For general rules of accounting, definitions and methods of accounting for long-term construction contracts see [each state adopting this Regulation should insert here reference to its laws and regulations relating in general to accounting methods of reporting income from long-term contracts. This Regulation assumes that the law of the adopting states permits the taxpayer to elect either the percentage of completion or completed contract method. If not, the Regulation will have to be modified to conform to an adopting state's accounting method for long-term construction contracts.]

(4) Apportionment of Business Income.

(i) In General. Business income is apportioned to this state by a three-factor formula consisting of property, payroll and sales regardless of the method of accounting for long-term contracts elected by the taxpayer. The total of the property, payroll and sales percentages is divided by three to determine the apportionment percentage. The apportionment percentage is then applied to business income to determine the amount apportioned to this state.

(ii) Percentage of Completion Method. Under this method of accounting for long-term contracts, the amount to be included each year as business income from each contract is the amount by which the gross contract price which corresponds to the percentage of the entire

contract which has been completed during the income year exceeds all expenditures made during the income year in connection with the contract. In so doing, account must be taken of the material and supplies on hand at the beginning and end of the income year for use in each such contract.

Example: A taxpayer using the percentage of completion method of accounting for long-term contracts, entered into a long-term contract to build a structure for $9,000,000. The contract allowed three years for completion and, as of the end of the second income year, the taxpayer's books of account, kept on the accrual method, disclosed the following:

	Receipts	Expenditures
End of 1st income year	$2,500,000	$2,400,000
End of 2nd income year	4,500,000	4,100,000
Totals	$7,000,000	$6,500,000

In computing the above expenditures, consideration was given to material and supplies on hand at the beginning and end of each income year. It was estimated that the contract was 30% completed at the end of the first income year and 80% completed at the end of the second income year. The amount to be included as business income for the first income year is $300,000 (30% of $9,000,000 or $2,700,000 less expenditures of $2,400,000 equals $300,000). The amount to be included as business income for the second income year is $400,000 (50% of $9,000,000 or $4,500,000 less expenditures of $4,100,000 equals $400,000).

(iii) Completed Contract Method. Under this method of accounting business income derived from long-term contracts is reported for the income year in which the contract is finally completed and accepted. Therefore, a special computation is required to compute the amount of business income attributable to this state from each completed contract (see subdivision (5) of this regulation). Thus, all receipts and expenditures applicable to such contracts whether complete or incomplete as of the end of the income year are excluded from business income derived from other sources, as for example, short-term contracts, interest, rents, royalties, etc., which is apportioned by the regular three-factor formula of property, payroll and sales.

(iv) Property Factor. In general the numerator and denominator of the property factor shall be determined as set forth in Article IV.10 to .12, inclusive, and Reg. IV.10 to .12, inclusive. However, the following special rules are also applicable:

(A) The average value of the taxpayer's cost (including materials and labor) of construction in progress, to the extent that such costs exceed progress billings (accrued or received, depending on whether the taxpayer is on the accrual or cash basis for keeping its accounts) shall be included in the denominator of the property factor. The value of any such

construction costs attributable to construction projects in this state shall be included in the numerator of the property factor.

Example 1: Taxpayer commenced a long-term construction project in this state as of the beginning of a given year. By the end of its second year, its equity in the costs of production to be reflected in the numerator and denominator of its property factor for such year is computed as follows:

	1st Year		**2nd Year**	
	Beginning	Ending	Beginning	Ending
Construction Costs	0	$1,000000		
Progress billings		600,000		
Balance 12/31-(1/1)		$400,000	$400,000	
Construction Costs - Total from beginning of project`				$5,000,000
Progress billings - Total from beginning of project				4,000,000
Balance 12/31				1,000,000
Balance beginning of year				400,000
Total				$1,400,000
Average (1/2) - Value used in property factor				$700,000

Note: It may be necessary to use monthly averages if yearly averages do not properly reflect the average value of the taxpayer's equity; see Article IV.12 and Reg. IV.12.

Example 2: Same facts as in Example 1, except that progress billings exceeded construction costs. No value for the taxpayer's equity in the construction project is shown in the property factor.

(B) Rent paid for the use of equipment directly attributable to a particular construction

project is included in the property factor at eight times the net annual rental rate even though such rental expense may be capitalized into the cost of construction.

(C) The property factor is computed in the same manner for all long-term contract methods of accounting and is computed for each income year even though under the completed contract method of accounting, business income is computed separately (see paragraph (5) below).

(v) Payroll Factor. In general the numerator and denominator of the payroll factor shall be determined as set forth in Article IV.13 and .14 and Reg. IV.13 and .14. However, the following special rules are also applicable:

(A) Compensation paid employees which is attributable to a particular construction project is included in the payroll factor even though capitalized into the cost of construction.

(B) Compensation paid employees who in the aggregate perform most of their services in a state to which their employer does not report them for unemployment tax purposes, shall nevertheless be attributed to the state in which the services are performed.

Example: A taxpayer engaged in a long-term contract in state X sends several key employees to that state to supervise the project. The taxpayer, for unemployment tax purposes, reports these employees to state Y where the main office is maintained and where the employees reside. For payroll factor purposes and in accordance with Article IV.14 and Reg. IV.14 thereunder, the compensation is assigned to the numerator of state X.

(C) The payroll factor is computed in the same manner for all long-term contract methods of accounting and is computed for each income year even though, under the completed contract method of accounting, business income is computed separately (see paragraph (5) below).

(vi) Sales Factor. In general, the numerator and denominator of the sales factor shall be determined as set forth in Article IV.15-.17, inclusive, and Reg. IV.15-.17, inclusive. However, the following special rules are also applicable:

(A) Gross receipts derived from the performance of a contract are attributable to this state if the construction project is located in this state. If the construction project is located partly within and partly without this state, the gross receipts attributable to this state are based upon the ratio which construction costs for the project in this state incurred during the income year bear to the total of construction costs for the entire project during the income year, or upon any other method, such as engineering cost estimates, which will provide a reasonable apportionment.

Example 1: A construction project was undertaken in this state by a calendar year taxpayer which had elected one of the long-term contract methods of accounting. The

following gross receipts (progress billings) were derived from the contract during the three income years that the contract was in progress.

	1st Year	2nd Year	3rd Year
Gross receipts	$1,000,000	$4,000,000	$3,000,000

The gross receipts to be reflected in both the numerator and denominator of the sales factor for each of the three years are the amounts shown.

Example 2: A taxpayer contracts to build a dam on a river at a point which lies half within this state and half within state X. During the taxpayer's first income year, construction costs in this state were $2,000,000. Total construction costs for the project during the income year were $3,000,000. Gross receipts (progress billings) for the year were $2,400,000. Accordingly, gross receipts of $1,600,000 ($2,000,000/$3,000,000 x $2,400,000) are included in the numerator of the sales factor.

(B) If the percentage of completion method is used, the sales factor includes only that portion of the gross contract price which corresponds to the percentage of the entire contract which was completed during the income year.

Example: A taxpayer which had elected the percentage of completion method of accounting entered into a long-term construction contract. At the end of its current income year (the second since starting the project), it estimated that the project was 30% completed. The bid price for the project was $9,000,000 and it had received $2,500,000 from progress billings as of the end of its current income year. The amount of gross receipts to be included in the sales factor for the current income year is $2,700,000 (30% of $9,000,000), regardless of whether the taxpayer uses the accrual method or the cash method of accounting for receipts and disbursements.

(C) If the completed contract method of accounting is used, the sales factor includes the portion of the gross receipts (progress billings) received or accrued, whichever is applicable, during the income year attributable to each contract.

Example 1: A taxpayer which had elected the completed contract method of accounting entered into a long-term construction contract. By the end of its current income year (the second since starting the project), it had billed and had accrued on its books a total of $5,000,000 of which $2,000,000 had accrued in the first year in which the contract was undertaken and $3,000,000 had accrued in the current (second) year. The amount of gross receipts to be included in the sales factor for the current income year is $3,000,000.

Example 2: Same facts as in Example 1 except that the taxpayer keeps its books

on the cash basis and, as of the end of its current income year, had received only $2,500,000 of the $3,000,000 billed during the current year. The amount of gross receipts to be included in the sales factor for the current income year is $2,500,000.

(D) The sales factor, except as noted above in subparagraphs (B) and (C), is computed in the same manner, regardless of which long-term method of accounting the taxpayer has elected, and is computed for each income year even though, under the completed contract method of accounting, business income is computed separately.

(vii) Apportionment Percentage. The total of the property, payroll and sales percentages is divided by three to determine the apportionment percentage. The apportionment percentage is then applied to business income to establish the amount apportioned to this state.

(5) Completed Contract Method - Special Computation. The completed contract method of accounting requires that the reporting of income (or loss) be deferred until the year in which the construction project is completed or accepted. Accordingly, a separate computation is made for each such contract completed during the income year, regardless of whether the project is located within or without this state, in order to determine the amount of income which is attributable to sources within this state. The amount of income from each contract completed during the income year apportioned to this state, plus other business income apportioned to this state by the regular three-factor formula such as interest income, rents, royalties, income from short-term contracts, etc., plus all nonbusiness income allocated to this state is the measure of tax for the income year.

The amount of income (or loss) from each contract which is derived from sources within this state using the completed contract method of accounting is computed as follows:

(i) In the income year in which the contract is completed, the income (or loss) therefrom is determined.

(ii) The income (or loss) determined at (i) above is apportioned to this state by the following method:

(A) A fraction is determined for each year during which the contract was in progress. The numerator is the amount of construction costs paid or accrued in each year during which the contract was in progress and the denominator is the total of all such construction costs for the project.

(B) Each percentage determined in (A) is multiplied by the apportionment formula percentage for that particular year as determined in subparagraph (4)(vii) of this regulation above.

(C) The percentages determined at (B) for each year during which the contract was in progress are totaled. The amount of total income (or loss) from the contract

determined at subparagraph (5)(i) of this regulation is multiplied by the total percentage. The resulting income (or loss) is the amount of business income from such contract derived from sources within this state.

Example 1: A taxpayer using the completed contract method of accounting for long-term contracts is engaged in three long-term contracts; Contract L in this state, Contract M in state X and Contract N in state Y. In addition, it has other business income (less expenses) during the income year 1972 from interest, rents and short-term contracts amounting to $500,000, and nonbusiness income allocable to this state of $8,000. During 1972, it completed Contract M in state X at a profit of $900,000. Contracts L and N in this state and state Y, respectively, were not completed during the income year. The apportionment percentages of the taxpayer as determined in subparagraph (4)(vii) of this regulation and the percentages of contract costs as determined in subparagraph (5)(ii) above for each year during which Contract M in state X was in progress are as follows:

	1970	1971	1972
Apportionment %	30%	20%	40%
% of Construction Costs of Contract M each year to total construction costs -(100%)	20%	50%	30%

The corporation's net income subject to tax in this state for 1972 is computed as follows:

Business Income	$500,000
Apportion 40% to this state	$200,000
Add: Income from Contract M*	$252,000
Total business income derived from sources within this state	452,000
Add: Nonbusiness income allocated to this state	8,000
Net income subject to tax	$460,000

*Income from Contract M apportioned to this state:

	1970	1971	1972	Total
Apportionment %	30%	20%	40%	
% of Construction Costs	20%	50%	30%	100%
Product	6%	10%	12%	28%

28% of $900,000 = $252,000

Example 2: Same facts as in Example 1 except that Contract L was started in 1972 in this state, the first year in which the taxpayer was subject to tax in this state. Contract L in

this state and Contract N in state Y are incomplete in 1972.

The corporation's net income subject to tax in this state for 1972 is computed as follows:

Business Income	$500,000
Apportion 40% to this state	$200,000
Add: Income from Contract M*	108,000
Total business income derived from sources within this state	$308,000
Add: Nonbusiness income allocated to this state	8,000
Net income subject to tax	$316,000

*Income from Contract M apportioned to this state:

	1970	1971	1972	Total
Apportionment %	0	0	40%	
% of Construction Costs	20%	50%	30%	100%
Product	0	0	12%	12%

12% of $900,000 = $108,000

Note: Only 12% is used to determine the income derived from sources within this state since the corporation was not subject to tax in this state prior to 1972.

Example 3: Same facts as in example 1 except that the figures relate to Contract L in this state and 1972 is the first year the corporation was taxable in another state (see Article IV.2 and .3 and Reg. IV.2(b)(1) and .3. Contracts M and N in states X and Y were started in 1972 and are incomplete.

The corporation's net income subject to tax in this state for 1972 is computed as follows:

Business Income	$500,000
Apportion 40% to this state	$200,000
Add: Income from Contract L*	738,000
Total business income derived from sources within this state	$938,000
Add: Nonbusiness income allocated to this state	8,000
Net income subject to tax	$946,000

*Income from Contract L apportioned to this state:

	1970	1971	1972	Total

Apportionment %	100%	100%	40%	
% of Construction Costs	20%	50%	30%	100%
Product	20%	50%	12%	82%

82% of $900,000 = $738,000

(6) Computation for Year of Withdrawal, Dissolution or Cessation of Business - Completed Contract Method. Use of the completed contract method of accounting for long-term contracts requires that income derived from sources within this state from incomplete contracts in progress outside this state on the date of withdrawal, dissolution or cessation of business in this state be included in the measure of tax for the taxable year during which the corporation withdraws, dissolves or ceases doing business in this state.

The amount of income (or loss) from each such contract to be apportioned to this state by the apportionment method set forth in subparagraph (5)(ii) of this regulation shall be determined as if the percentage of completion method of accounting were used for all such contracts on the date of withdrawal, dissolution or cessation of business. The amount of business income (or loss) for each such contract shall be the amount by which the gross contract price from each such contract which corresponds to the percentage of the entire contract which has been completed from the commencement thereof to the date of withdrawal, dissolution or cessation of business exceeds all expenditures made during such period in connection with each such contract. In so doing, account must be taken of the material and supplies on hand at the beginning and end of the income year for use in each such contract.

Example: A construction contractor qualified to do business in this state had elected the completed contract method of accounting for long-term contracts. It was engaged in two long-term contracts. Contract L in this state was started in 1971 and completed at a profit of $900,000 on 12/16/73. The taxpayer withdrew on 12/31/73. Contract M in state X was started in 1972 and was incomplete on 12/31/73. The apportionment percentages of the taxpayer, as determined at subdivision (4) of this regulation, and percentages of construction costs, as determined in subparagraph (5)(ii) of this regulation, for each year during which Contract M in state X was in progress are as follows:

	1971	1972	1973	Total
Apportionment %	30%	20%	40%	
% of Construction Costs:				
Contract L, this state	20%	50%	30%	100%
Contract M, state X	0	10%	25%	35%

The corporation had other business income (net of expenses) of $500,000 during 1972 and $300,000 during 1973. The gross contract price of Contract M (state X) was $1,000,000, and it was estimated to be 35% completed on 12/31/73. Total expenditures

to date for Contract M (state X) were $300,000 for the period ended 12/31/73.

The measure of tax for the taxable year ended 12/31/73 is computed as follows:

		Taxable Year 1973
	Income Year 1972	Income Year 1973
Business Income	$500,000	$300,000
Apportionment % to this state	20%	40%
Amount Apportioned to this state	$100,000	$120,000
Add: Income from contracts:		
L* (this state)		$252,000
M** (state X)		6,000
Total business income derived from sources within this state	$100,000	$378,000

*Income from Contract L apportioned to this state:

	1971	1972	1973	Total
Apportionment %	30%	20%	40%	
% of Construction Costs	20%	50%	30%	100%
Product	6%	10%	12%	28%

28% of $900,000=$252,000

**Income from Contract M apportioned to this state:

	1971	1972	1973	Total
Apportionment %	0	20%	40%	
% of Construction Costs	0	10%	25%	35%
Product	0	2%	10%	12%

12% of 50,000***=$6,000

***Computation of apportionable income from Contract M based on percentage of completion method:

Total Contract Price	$1,000,000
Estimated to be 35% completed	$350,000

Less: total expenditures to date	300,000
Apportionable income	$50,000

••• Reg. IV.18.(e). Special Rules: Airlines. [Adopted July 14, 1983]

The following special rules are established with respect to airlines:

(1) In General. Where an airline has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to Article IV. of the Multistate Tax Compact except as modified by this regulation.

(2) Apportionment of Business Income.

(i) General Definitions.

The following definitions are applicable to the terms used in the apportionment factor descriptions.

A. "Value" of owned real and tangible personal property shall mean its original cost. (See Article IV.11. and Regulation IV.11(a).)

B. "Cost of aircraft by type" means the average original cost or value of aircraft by type which are ready for flight.

C. "Original cost" means the initial federal tax basis of the property plus the value of capital improvements to such property, except that, for this purpose, it shall be assumed that Safe Harbor Leases are not true leases and do not affect the original initial federal tax basis of the property. (See Regulation IV.11(a).)

D. "Average value" of the property means the amount determined by averaging the values at the beginning and ending of the income year, but the [insert here the appropriate title of the administrative agency] may require the averaging of monthly values during the income year if such averaging is necessary to reflect properly the average value of the airline's property. (See Article IV.12. and Regulation IV.12.)

E. The "value" of rented real and tangible personal property means the product of eight (8) times the net annual rental rate. (See Article IV.11. and Regulation IV.11(b).)

F. "Net annual rental rate" means the annual rental rate paid by the taxpayer.

G. "Property used during the income year" includes property which is available for use in the taxpayer's trade or business during the income year.

H. "Aircraft ready for flight" means aircraft owned or acquired through rental or lease (but not interchange) which are in the possession of the taxpayer and are available for service on the taxpayer routes.

I. "Revenue service" means the use of aircraft ready for flight for the production of

revenue.

J. "Transportation revenue" means revenue earned by transporting passengers, freight and mail as well as revenue earned from liquor sales, pet crate rentals, etc.

K. "Departures" means, for purposes of these regulations, all takeoffs, whether they be regularly scheduled or charter flights, that occur during revenue service.

(ii) Property Factor

A. Property valuation. Owned aircraft shall be valued at its original cost and rented aircraft shall be valued at eight (8) times the net annual rental rate in accordance with Article IV.11. and Regulation IV.11. The use of the taxpayer's owned or rented aircraft in an interchange program with another air carrier will not constitute a rental of such aircraft by the airlines to the other participating airline. Such aircraft shall be accounted for in the property factor of the owner. Parts and other expendables, including parts for use in contract overhaul work, will be valued at cost.

B. The denominator and numerator of the property factor. The denominator of the property factor shall be the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the income year. The numerator of the property factor shall be the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year.

In determining the numerator of the property factor, all property except aircraft ready for flight shall be included in the numerator of the property factor in accordance with Article IV.10.-.12, inclusive. Aircraft ready for flight shall be included in the numerator of the property factor in the ratio calculated as follows:

Departures of aircraft from locations in this state weighted as to the cost and value of aircraft by type compared to total departures similarly weighted.

(iii) The Payroll Factor

The denominator of the payroll factor is the total compensation paid everywhere by the taxpayer during the income year. (See Article IV.13.-.14.) The numerator of the payroll factor is the total amount paid in this state during the income year by the taxpayer for compensation. With respect to non-flight personnel, compensation paid to such employees shall be included in the numerator as provided in Article IV.13-.14. With respect to flight personnel (the air crew aboard an aircraft assisting in the operations of the aircraft or the welfare of passengers while in the air), compensation paid to such employees shall be included in the ratio of departures of aircraft from locations in this state, weighted as to the cost and value of aircraft by type compared to total departures similarly weighted, multiplied by the total flight personnel compensation.

(iv) Sales (Transportation Revenue) Factor.

The transportation revenue derived from transactions and activities in the regular course of the trade or business of the taxpayer and miscellaneous sales of merchandise, etc., are included in the denominator of the revenue factor. (See Article IV.1. and Regulation IV.1.) Passive income items such as interest, rental income, dividends, etc., will not be included in the denominator nor will the proceeds or net gains or losses from the sale of aircraft be included. The numerator of the revenue factor is the total revenue of the taxpayer in this state during the income year. The total revenue of the taxpayer in this state during the income year is the result of the following calculation:

The ratio of departures of aircraft in this state weighted as to the cost and value of aircraft by type, as compared to total departures similarly weighted multiplied by the total transportation revenue. The product of this calculation is to be added to any non-flight revenues directly attributable to this state.

(3) Records. The taxpayer must maintain the records necessary to arrive at departures by type of aircraft as used in these regulations. Such records are to be subject to review by the respective state taxing authorities or their agents.

EXAMPLES OF THE MANNER IN WHICH THE MULTISTATE TAX COMMISSION AIRLINE REGULATION WOULD APPLY TO SPECIFIC FACT SITUATIONS

Example 1: Assume the following facts for an airline for a tax year:

1. It has ten 747s ready for flight and in revenue service at an average cost per unit of $40,000,000 for nine of the aircraft. It rents the tenth 747 from another airline for $9,000,000 per year. At eight times rents, the latter is valued at $72,000,000 for apportionment purposes. The total 747 valuation is, therefore, $432,000,000 for property factor denominator purposes.

2. It has twenty 727s ready for flight in revenue service at an average cost per unit of $20,000,000. The total 727 valuation is, therefore, $400,000,000 for property factor denominator purposes.

3. It has nonflight tangible property (n.t.p.) valued at an original cost of $200,000,000.

4. It has the following annual payroll:

Flight personnel	$60,000,000
Nonflight personnel	40,000,000
Total	$100,000,000

5. From its operations, it has total receipts of $50,000,000, business net income of $1,000,000, and no nonbusiness income.

6. It has the following within state X:

a. 10% of its 747 flight departures (.10 x $432,000,000)	$43,200,000
b. 20% of its 727 flight departures (.20 x $400,000,000)	$80,000,000
c. 5% of its n.t.p. (.05 x$200,000,000)	$10,000,000
d. 15% of its n.p. payroll (.15x$40,000,000)	$6,000,000

7. State X has a corporate tax rate of 10%.

The airline's tax liability to state X would be determined as follows:

Property Factor:

$$\frac{43{,}200{,}000\ (747s) + 80{,}000{,}000\ (727s) + 10{,}000{,}000\ (n.t.p.)}{432{,}000{,}000 + 400{,}000{,}000 + 200{,}000{,}000} = \frac{133{,}200{,}000}{1{,}032{,}000{,}000} = .1291$$

Sales Factor:

$$\frac{43{,}200{,}000\ (747s) + 80{,}000{,}000\ (727s)}{432{,}000{,}000 + 400{,}000{,}000} = \frac{123{,}200{,}000}{832{,}000{,}000} = .1481$$

Payroll Factor:

$$\frac{6{,}000{,}000\ (n.p.) + \frac{8{,}880{,}000(.148 \times 60{,}000{,}000)(flight)}{100{,}000{,}000}}{} = \frac{14{,}8800{,}000}{100{,}000{,}000} = .1488$$

Average ratio: (.1291 + .1481 + .1488)/3 = .4260/3 = .1420

Taxable Income in State X: .1420 x $1,000,000 = $142,000

Tax Liability to State X: .10 x $142,000 = $14,200

Example 2: Same facts except that paragraphs 6 and 7 are changed to read:

6. It has the following within state Y:

a. 6% of its 747 flight departures (.6 x $432,000,000)	$25,920,000
b. 31% of its 727 flight departures (.31 x $400,000,000)	$124,000,000
c. 3% of its n.t.p. (.03 x$200,000,000)	$6,000,000
d. 7% of its n.p. payroll (.07x$40,000,000)	$2,800,000

7. State Y has a corporate tax rate of 6.5%.

The airline's tax liability to state Y would be determined as follows:

Property Factor:

$$\frac{25{,}920{,}000\ (747s) + 124{,}000{,}000\ (727s) + 6{,}000{,}000\ (n.t.p.)}{432{,}000{,}000 + 400{,}000{,}000 + 200{,}000{,}000} = \frac{155{,}920{,}000}{1{,}032{,}000{,}000} = .1511$$

Sales Factor:

$$\frac{25{,}920{,}000\ (747s) + 124{,}000{,}000\ (727s)}{432{,}000{,}000 + 400{,}000{,}000} = \frac{149{,}920{,}000}{832{,}000{,}000} = .1802$$

Payroll Factor:

$$\frac{2{,}800{,}000\text{(n.p.)} + 10{,}812{,}000(.1802 \times 60{,}000{,}000)\text{(flight)}}{40{,}000{,}000 + 60{,}000{,}000} = \frac{13{,}612{,}000}{100{,}000{,}000} = .1361$$

Average ratio: (.1511 + .1802 + .1361)/3 = .4674/3 = .1558

Taxable Income in State Y: .1558 x $1,000,000 = $155,800

Tax Liability to State Y: .65 x $155,800 = $10,127

••• Reg. IV.18.(f). Special Rules: Railroads. [Adopted July 16, 1981]

The following special rules are established in respect to railroads:

(1) In General. Where a railroad has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to this regulation. In such cases, the first step is to determine what portion of the railroad's income constitutes "business" income and which portion constitutes "nonbusiness" income under Article IV.1 and Regulation IV.1 thereunder. Nonbusiness income is directly allocable to specific states pursuant to the provisions of Article IV.5 to .8, inclusive. Business income is apportioned among the states in which the business is conducted pursuant to the property, payroll and sales apportionment factors set forth in this regulation. The sum of (1) the items of nonbusiness income directly allocated to this state and (2) the amount of business income attributable to this state constitutes the amount of the taxpayer's entire net income which is subject to tax by this state.

(2) Business and Nonbusiness Income. For definitions, rules and examples for determining business and nonbusiness income, see Reg. IV.1.

(3) Apportionment of Business Income.

(i) In General. The property factor shall be determined in accordance with Reg. IV.10.-.12., inclusive, the payroll factor in accordance with Reg. IV.13., and the sales factor in accordance with Reg. IV.14.-.17, inclusive, except as modified in this regulation.

(ii) The Property Factor.

A. Property Valuation. Owned property shall be valued at its original cost and property rented from others shall be valued at eight (8) times the net annual rental rate in accordance with Article IV.11. and Reg. IV.11. Railroad cars owned and operated by other railroads and temporarily used by the taxpayer in its business and for which a per diem or mileage charge is made are not included in the property factor as rented property. Railroad cars owned and operated by the taxpayer and temporarily used by other railroads in their business and for which a per diem charge is made by the taxpayer are included in the property factor of the taxpayer.

B. General Definitions. The following definitions are applicable to the numerator and denominator of the property factor:

1. "Original cost" is deemed to be the basis of the property for federal income tax purposes (prior to any federal income tax adjustments except for subsequent capital additions, improvements thereto or partial dispositions); or, if the property has no such basis, the valuation of such property for Interstate Commerce Commission purposes. If the original cost of property is unascertainable under the foregoing valuation standards, the property is included in the

property factor at its fair market value as of the date of acquisition by the taxpayer (Reg. IV.11.(a)).

2. "Rent" does not include the per diem and mileage charges paid by the taxpayer for the temporary use of railroad cars owned or operated by another railroad.

3. The "value" of owned real and tangible personal property shall mean its original cost. (See Article IV.11 and Reg. IV.11(a).)

4. "Average value" of property means the amount determined by averaging the values at the beginning and ending of the income tax year, but the [insert here the appropriate title of the administrative agency] may require the averaging of monthly values during the income year or such averaging as necessary to effect properly the average value of the railroad's property. (See Article IV.12. and Reg. IV.12.)

5. The "value" of rented real and tangible personal property means the product of eight (8) times the net annual rental rate. (See Article IV.11. and Reg. IV.11(b).)

6. "Net annual rental rate" means the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

7. "Property used during the income year" includes property which is available for use in the taxpayer's trade or business during the income year.

8. A "locomotive-mile" is the movement of a locomotive (a self-propelled unit of equipment designed solely for moving other equipment) a distance of one mile under its own power.

9. A "car-mile" is a movement of a unit of car equipment a distance of one mile.

C. The Denominator and Numerator of the Property Factor. The denominator of the property factor shall be the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the income year. The numerator of the property factor shall be the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year.

In determining the numerator of the property factor, all property except mobile or movable property such as passenger cars, freight cars, locomotives and freight containers which are located within and without this state during the income year shall be included in the numerator of the property factor in accordance with Article IV.10.-.12., inclusive, and Regulation IV.10.-.12, inclusive.

Mobile or movable property such as passenger cars, freight cars, locomotives and freight containers which are located within and without this state during the income year shall be included in the numerator of the property factor in the ratio which "locomotive-miles" and "car-miles" in the state bear to the total everywhere.

(iii) The Payroll Factor. The denominator of the payroll factor is the total compensation paid everywhere by the taxpayer during the income year for the production of business income. (See Article IV.13.-14. and Reg. IV.13.-.14.) The numerator of the payroll factor is the total amount paid in this state during the income year by the taxpayer for compensation. With respect to all personnel except enginemen and trainmen performing services on interstate trains, compensation paid to such employees shall be included in the numerator as provided in Article IV.13.-.14 and Reg. IV.13.-.14.

With respect to enginemen and trainmen performing services on interstate trains, compensation paid to such employees shall be included in the numerator of the payroll factor in the ratio which their services performed in this state bear to their services performed everywhere. Compensation for services performed in this state should be deemed to be the compensation reported or required to be reported by such employees for determination of their income tax liability to this state.

(iv) The Sales (Revenue) Factor.

A. In General. All revenue derived from transactions and activities in the regular course of the trade or business of the taxpayer which produces business income, except per diem and mileage charges which are collected by the taxpayer, is included in the denominator of the revenue factor. (See Article IV.1. and Reg. IV.1.)

The numerator of the revenue factor is the total revenue of the taxpayer in this state during the income year. The total revenue of the taxpayer in this state during the income year, other than revenue from hauling freight, passengers, mail and express, shall be attributable to this state in accordance with Article IV.15.-.17. and Regulation IV.15.-.17.

B. Numerator of Sales (Revenue) Factor From Freight, Mail and Express. The total revenue of the taxpayer in this state during the income year for the numerator of the revenue factor from hauling freight, mail and express shall be attributable to this state as follows:

1. All receipts from shipments which both originate and terminate within this state; and

2. That portion of the receipts from each movement or shipment passing through, into, or out of this state is determined by the ratio which the miles traveled by such movement or shipment in this state bear to the total miles traveled by such movement or shipment from point of origin to destination.

C. Numerator of Sales (Revenue) Factor from Passengers. The numerator of the sales

(revenue) factor shall include:

1. All receipts from the transportation of passengers (including mail and express handled in passenger service) which both originate and terminate within this state; and

2. That portion of the receipts from the transportation of interstate passengers (including mail and express handled in passenger service) determined by the ratio which revenue passenger miles in this state bear to the total everywhere.

••• Reg. IV.18.(g). Special Rules: Trucking Companies.
[Adopted July 11, 1986; amended July 27, 1989]

The following special rules are established with respect to trucking companies:

(1) In General. As used in this regulation, the term "trucking company" means a motor common carrier, a motor contract carrier, or an express carrier which primarily transports tangible personal property of others by motor vehicle for compensation. Where a trucking company has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to this regulation. In such cases, the first step is to determine what portion of the trucking company's income constitutes "business" income and what portion constitutes "nonbusiness" income under Article IV.1 of the Multistate Tax Compact and Regulation IV.1 thereunder. Nonbusiness income is directly allocable to specific states pursuant to the provisions of Article IV.5 to .8, inclusive. Business income is apportioned among the states in which the business is conducted and pursuant to the property, payroll, and sales apportionment factors set forth in this regulation. The sum of (i) the items of nonbusiness income directly allocated to this state and (ii) the amount of business income attributable to this state constitutes the amount of the taxpayer's entire net income which is subject to tax in this state.

(2) Business and Nonbusiness Income. For definitions, rules, and examples for determining business and nonbusiness income, see Regulation IV.1.

(3) Apportionment of Business Income

(i) In General. The property factor shall be determined in accordance with Regulation IV.10 to .12, inclusive, the payroll factor in accordance with Regulation IV.13 to .14, and the sales factor in accordance with Regulation IV.15 to .17, inclusive, except as modified by this regulation.

(ii) The Property Factor

A. Property Valuation. Owned property shall be valued at its original cost and property rented from others shall be valued at eight (8) times the net annual rental rate in accordance with Article IV.11 and Regulation IV.11.

B. General Definitions. The following definitions are applicable to the numerator and denominator of the property factor, as well as other apportionment factor descriptions:

1. "Average value" of property means the amount determined by averaging the values at the beginning and end of the income tax year, but the [insert here the title of the appropriate administrative agency] may require the averaging of monthly values during the income year or

such averaging as is necessary to reflect properly the average value of the trucking company's property. (See Article IV.12 and Regulation IV.12.)

2. "Mobile property" means all motor vehicles, including trailers, engaged directly in the movement of tangible personal property.

3. A "mobile property mile" is the movement of a unit of mobile property a distance of one mile whether loaded or unloaded.

4. "Original cost" is deemed to be the basis of the property for federal income tax purposes (prior to any federal income tax adjustments, except for subsequent capital additions, improvements thereto, or partial dispositions); or, if the property has no such basis, the valuation of such property for Interstate Commerce Commission purposes. If the original cost of property is unascertainable under the foregoing valuation standards, the property is included in the property factor at its fair market value as of the date of acquisition by the taxpayer. (Regulation IV.11.(a).)

5. "Property used during the course of the income year" includes property which is available for use in the taxpayer's trade or business during the income year.

6. The "value" of owned real and tangible personal property means its original cost. (See Article IV.11 and Regulation IV.11.(a).)

7. The "value" of rented real and tangible personal property means the product of eight (8) times the net annual rental rate. (See Article IV.11 and Regulation IV.11.(b).)

C. The Denominator and Numerator of the Property Factor. The denominator of the property factor shall be the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the income year. The numerator of the property factor shall be the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year. In the determination of the numerator of the property factor, all property, except mobile property as defined in this regulation, shall be included in the numerator of the property factor in accordance with Article IV.10 to .12, inclusive, and Regulation IV.10 to .12, inclusive.

Mobile property, as defined in this regulation, which is located solely within this state during the income year shall be included in the numerator of the property factor.

Mobile property as defined in this regulation, which is located within and without this state during the income year shall be included in the numerator of the property factor in the ratio which mobile property miles in the state bear to the total mobile property miles.

(iii) The Payroll Factor. The denominator of the payroll factor is the compensation paid everywhere by the taxpayer during the income year for the production of business income. (See

Article IV.13 and .14 and Regulation IV.13 and .14.) The numerator of the payroll factor is the total compensation paid in this state during the income year by the taxpayer. With respect to all personnel, except those performing services within and without this state, compensation paid to such employees shall be included in the numerator as provided in Article IV.13 and .14 and Regulation IV.13 and .14.

With respect to personnel performing services within and without this state, compensation paid to such employees shall be included in the numerator of the payroll factor in the ratio which their services performed in this state bear to their services performed everywhere based on mobile property miles.

(iv) The Sales (Revenue) Factor

A. In General. All revenue derived from transactions and activities in the regular course of the taxpayer's trade or business which produce business income shall be included in the denominator of the revenue factor. (See Article IV.1 and Regulation IV.1.)

The numerator of the revenue factor is the total revenue of the taxpayer in this state during the income year. The total state revenue of the taxpayer, other than revenue from hauling freight, mail, and express, shall be attributable to this state in accordance with Article IV.15 through .17 and Regulation IV.15 through .17.

B. Numerator of the Sales (Revenue) Factor From Freight, Mail, and Express. The total revenue of the taxpayer attributable to this state during the income year from hauling freight, mail, and express shall be:

1. Intrastate: All receipts from any shipment which both originates and terminates within this state; and,

2. Interstate: That portion of the receipts from movements or shipments passing through, into, or out of this state as determined by the ratio which the mobile property miles traveled by such movements or shipments in this state bear to the total mobile property miles traveled by movements or shipments from points of origin to destination.

(4) Records. The taxpayer shall maintain the records necessary to identify mobile property and to enumerate by state the mobile property miles traveled by such mobile property as those terms are used in this regulation. Such records are subject to review by [insert here the title of the appropriate administrative agency] or its agents.

(5) De Minimis Nexus Standard. Notwithstanding any provision contained herein, this Regulation IV.18.(g) shall not apply to require the apportionment of income to this state if the trucking company during the course of the income tax year neither:

a. owns nor rents any real or personal property in this state, except mobile property; nor

b. makes any pick-ups or deliveries within this state; nor

c. travels more than twenty-five thousand mobile property miles within this state; provided that the total mobile property miles traveled within this state during the income tax year do not exceed three percent of the total mobile property miles traveled in all states by the trucking company during that period; nor

d. makes more than twelve trips into this state.

••• Reg.IV.18(h). Special Rules: Television and Radio Broadcasting
[Adopted August 31, 1990; amended April 25, 1996]

The following special rules are established in respect to the apportionment of income from television and radio broadcasting by a broadcaster that is taxable both in this state and in one or more other states.

(1) In General. When a person in the business of broadcasting film or radio programming, whether through the public airwaves, by cable, direct or indirect satellite transmission or any other means of communication, either through a network (including owned and affiliated stations) or through an affiliated, unaffiliated or independent television or radio broadcasting station, has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to Article IV. of the Multistate Tax Compact and the regulations issued thereunder by this state, except as modified by this regulation.

(2) Business and Nonbusiness Income. For definitions, regulations and examples for determining whether income shall be classified as "business" or "nonbusiness" income, see Reg. IV.1.

(3) Definitions. The following definitions are applicable to the terms contained in this regulation, unless the context clearly requires otherwise.

(i) "Film" or "film programming" means any and all performances, events or productions telecast on television, including but not limited to news, sporting events, plays, stories or other literary, commercial, educational or artistic works, through the use of video tape, disc or any other type of format or medium.

Each episode of a series of films produced for television shall constitute a separate "film" notwithstanding that the series relates to the same principal subject and is produced during one or more tax periods.

(ii) "Outer-jurisdictional" property means certain types of tangible personal property, such as orbiting satellites, undersea transmission cables and the like, that are owned or rented by the taxpayer and used in the business of telecasting or broadcasting, but which are not physically located in any particular state.

(iii) "Radio" or "radio programming" means any and all performances, events or productions broadcast on radio, including but not limited to news, sporting events, plays, stories or other literary, commercial, educational or artistic works, through the use of an audio tape, disc or any other format or medium.

Each episode of a series of radio programming produced for radio broadcast shall

constitute a separate "radio programming" notwithstanding that the series relates to the same principal subject and is produced during one or more tax periods.

(iv) "Release" or “in release” means the placing of film or radio programming into service. A film or radio program is placed into service when it is first broadcast to the primary audience for which the program was created. Thus, for example, a film is placed in service when it is first publicly telecast for entertainment, educational, commercial, artistic or other purpose. Each episode of a television or radio series is placed in service when it is first broadcast. A program is not placed in service merely because it is completed and therefore in a condition or state of readiness and availability for broadcast or, merely because it is previewed to prospective sponsors or purchasers.

(v) "Rent" shall include license fees or other payments or consideration provided in exchange for the broadcast or other use of television or radio programming.

(vi) A "subscriber" to a cable television system is the individual residence or other outlet which is the ultimate recipient of the transmission.

(vii) "Telecast" or "broadcast" (sometimes used interchangeably with respect to television) means the transmission of television or radio programming, respectively, by an electronic or other signal conducted by radio waves or microwaves or by wires, lines, coaxial cables, wave guides, fiber optics, satellite transmissions directly or indirectly to viewers and listeners or by any other means of communications.

(4) Apportionment of Business Income.

(i) In General. The property factor shall be determined in accordance with Regulation IV.10 through 12., the payroll factor in accordance with Regulation IV.13. and 14., and the sales factor in accordance with Regulation IV.15. and 16., except as modified by this regulation.

(ii) The Property Factor.

A. In General

1. In the case of rented studios, the net annual rental rate shall include only the amount of the basic or flat rental charge by the studio for the use of a stage or other permanent equipment such as sound recording equipment and the like; except that additional equipment rented from other sources or from the studio not covered in the basic or flat rental charge and used for one week or longer (even though rented on a day-to-day basis) shall be included. Lump-sum net rental payments for a period which encompasses more than a single income year shall be assigned ratably over the rental period.

2. No value or cost attributable to any outerjurisdictional, film or radio programming

property shall be included in the property factor at any time.

B. Property Factor Denominator.

1. All real property and tangible personal property (other than outer-jurisdictional and film or radio programming property), whether owned or rented, which is used in the business shall be included in the denominator of the property factor.

2. Audio or video cassettes, discs or similar medium containing film or radio programming and intended for sale or rental by the taxpayer for home viewing or listening shall be included in the property factor at their original cost. To the extent that the taxpayer licenses or otherwise permits others to manufacture or distribute such cassettes, discs or other medium containing film or radio programming for home viewing or listening, the value of said cassettes, discs or other medium shall include the license, royalty or other fees received by the taxpayer capitalized at a rate of eight times the gross receipts derived therefrom during the income year.

3. Outer-jurisdictional, film and radio programming property shall be excluded from the denominator of the property factor.

C. Property Factor Numerator.

1. With the exception of outer-jurisdictional, film and radio programming property, all real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period shall be included in the numerator of the property factor as provided in Regulation IV.10.(d).

2. Outer-jurisdictional, film and radio programming property shall be excluded from the numerator of the property factor.

Example: XYZ Television Co. has a total value of all of its property everywhere of $500,000,000, including a satellite valued at $50,000,000 that was used to telecast programming into this state and $150,000,000 in film property of which $1,000,000's worth was located in this state the entire year. The total value of real and tangible personal property, other than film programming property, located in this state for the entire income year was valued at $2,000,000; and the movable and mobile property described in subparagraph C.1. was determined to be of a value of $4,000,000 and such movable and mobile property was used in this state for 100 days. The total value of property to be attributed to this state would be determined as follows:

Value of property permanently in state:	$2,000,000
Value of mobile and movable property: (100/365 or .2739 x $4,000,000):	$1,095,600

Total value of property to be included in the state's property factor numerator (outer-jurisdictional and film property excluded):	$3,095,600
Total value of property to be used in the denominator ($500,000,000-$200,000,000)	$300,000,000
Total property factor ($3,095,600/$300,000,000):	.0103

(iii) The Payroll Factor.

A. Payroll Factor Denominator.

The denominator of the payroll factor shall include all compensation, including residual and profit participation payments, paid to employees during the income year, including that paid to directors, actors, newscasters and other talent in their status as employees.

B. Payroll Factor Numerator.

Compensation for all employees shall be attributed to the state or states as may determined by the application of the provisions of Reg.IV.13. and 14.

(iv) The Sales Factor.

A. Sales Factor Denominator.

The denominator of the sales factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts excluded under Reg.IV.18.(c).

B. Sales Factor Numerator.

The numerator of the sales factor shall include all gross receipts of the taxpayer from sources within this state, including, but not limited to the following:

1. Gross receipts, including advertising revenue, from television film or radio programming in release to or by television and radio stations located in this state.

2. Gross receipts, including advertising revenue, from television film or radio

programming in release to or by a television station (independent or unaffiliated) or network of stations for broadcast shall be attributed to this state in the ratio (hereafter "audience factor") that the audience for such station (or owned and affiliated stations in the case of networks) located in this state bears to the total audience for such station (or owned and affiliated stations in the case of networks).

The audience factor for television or radio programming shall be determined by the ratio that the taxpayer's in-state viewing (listening) audience bears to its total viewing (listening) audience. Such audience factor shall be determined either by reference to the books and records of the taxpayer or by reference to published rating statistics, provided the method used by the taxpayer is consistently used from year to year for such purpose and fairly represents the taxpayer’s activity in the state.

3. Gross receipts from film programming in release to or by a cable television system shall be attributed to this state in the ratio (hereafter "audience factor") that the subscribers for such cable television system located in this state bears to the total subscribers of such cable television system. If the number of subscribers cannot be accurately determined from the books and records maintained by the taxpayer, such audience factor ratio shall be determined on the basis of the applicable year's subscription statistics located in published surveys, provided that the source selected is consistently used from year to year for that purpose.

4. Receipts from the sale, rental, licensing or other disposition of audio or video cassettes, discs, or similar medium intended for home viewing or listening shall be included in the sales factor as provided in Reg. IV. 16.

••• Reg.IV.18.(i). Special Rules: [Reserved]

••• Reg.IV.18.(j). Special Rules: Publishing [Adopted July 30, 1993]

The following special rules are established with respect to the apportionment of income derived from the publishing, sale, licensing or other distribution of books, newspapers, magazines, periodicals, trade journals or other printed material.

(1) In General. Except as specifically modified by this regulation, when a person in the business of publishing, selling, licensing or distributing newspapers, magazines, periodicals, trade journals or other printed material has income from sources both within and without this state, the amount of business income from sources within this state from such business activity shall be determined pursuant to [Article IV. of the Multistate Tax Compact and the regulations adopted thereunder].

(2) Definitions. The following definitions are applicable to the terms contained in this regulation, unless the context clearly requires otherwise.

(i) "Outer-jurisdictional property" means certain types of tangible personal property, such as orbiting satellites, undersea transmission cables and the like, that are owned or rented by the taxpayer and used in the business of publishing, licensing, selling or otherwise distributing printed material, but which are not physically located in any particular state.

(ii) "Print or printed material" includes, without limitation, the physical embodiment or printed version of any thought or expression including, without limitation, a play, story, article, column or other literary, commercial, educational, artistic or other written or printed work. The determination of whether an item is or consists of print or printed material shall be made without regard to its content. Printed material may take the form of a book, newspaper, magazine, periodical, trade journal or any other form of printed matter and may be contained on any medium or property.

(iii) "Purchaser" and "Subscriber" mean the individual, residence, business or other outlet which is the ultimate or final recipient of the print or printed material . Neither of such terms shall mean or include a wholesaler or other distributor of print or printed material.

(iv) "Terrestrial facility" shall include any telephone line, cable, fiber optic, microwave, earth station, satellite dish, antennae or other relay system or device that is used to receive, transmit, relay or carry any data, voice, image or other information that is transmitted from or by any outer-jurisdictional property to the ultimate recipient thereof.

(3) Apportionment of Business Income.

(i) The Property Factor.

A. Property Factor Denominator.

1. All real and tangible personal property, including outer-jurisdictional property, whether owned or rented, which is used in the business shall be included in the denominator of the property factor.

B. Property Factor Numerator.

1. All real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period shall be included in the numerator of the property factor.

2. Outer-jurisdictional property owned or rented by the taxpayer and used in this state during the tax period shall be included in the numerator of the property factor in the ratio which the value of such property that is attributable to its use by the taxpayer in business activities in this state bears to the total value of such property that is attributable to its use in the taxpayer's business activities everywhere.

The value of outer-jurisdictional property to be attributed to the numerator of the property factor of this state shall be determined by the ratio that the number of uplinks and downlinks (sometimes referred to as "half-circuits") that were used during the tax period to transmit from this state and to receive in this state any data, voice, image or other information bears to the total number of uplinks and downlinks or half-circuits that the taxpayer used for transmissions everywhere.

Should information regarding such uplink and downlink or half-circuit usage not be available or should such measurement of activity not be applicable to the type of outer-jurisdictional property used by the taxpayer, the value of such property to be attributed to the numerator of the property factor of this state shall be determined by the ratio that the amount of time (in terms of hours and minutes of use) or such other measurement of use of outer-jurisdictional property that was used during the tax period to transmit from this state and to receive in this state any data, voice, image or other information bears to the total amount of time or other measurement of use that was used for transmissions everywhere.

3. Outer-jurisdictional property shall be considered to have been used by the taxpayer in its business activities within this state when such property, wherever located, has been employed by the taxpayer in any manner in the publishing, sale, licensing or other distribution of books, newspapers, magazines or other printed material and any data, voice, image or other information is transmitted to or from this state either through an earth station or terrestrial facility located in this state.

Example: One example of the use of outer-jurisdictional property is where the taxpayer either owns its own communications satellite or leases the use of uplinks, downlinks or circuits or time on a communications satellite for the purpose of sending messages to its newspaper printing facilities or employees in a state. The state or states in which any printing facility that receives the satellite communications is located and the state from which the communications were sent would, under this regulation, apportion the cost of the owned or rented satellite to their respective property factors based upon the ratio of the in-state use of said satellite to its total usage everywhere.

Assume that ABC Newspaper Co. owns a total of $400,000,000 of property everywhere and that, in addition, it owns and operates a communication satellite for the purpose of sending news articles to its printing plant in this state, as well as for communicating with its printing plants and facilities or news bureaus, employees and agents located in other states and throughout the world. Also assume that the total value of its real and tangible personal property that was permanently located in this state for the entire income year was valued at $3,000,000. Assume also that the total original cost of the satellite is $100,000,000 for the tax period and that of the 10,000 uplinks and downlinks of satellite transmissions used by the taxpayer during the tax period, 200 or 2% are attributable to its satellite communications received in and sent from this state. Assume further that the company's mobile property that was used partially within this state, consisting of 40 delivery trucks, were determined to have an original cost of $4,000,000 and such mobile property was used in this state for 95 days.

The total value of property to be attributed to this state would be determined as follows:

Value of property permanently in state:	$3,000,000
Value of mobile property: 95/365 or (.260274) x $4,000,000:	$1,041,096
Value of leased satellite property used in-state: (.02) x $100,000,000:	$2,000,000
Total value of property attributable to state:	$6,041,096
Total property factor %: $6,041,096/($500,000,000):	1.2082%

(ii) The Payroll Factor.

The payroll factor shall be determined in accordance with Article IV.14. of the Multistate Tax Compact and the regulations promulgated thereunder.

(iii) The Sales Factor.

A. Sales Factor Denominator.

The denominator of the sales factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts that may be excluded under Reg.IV.15 through 18.

B. Sales Factor Numerator.

The numerator of the sales factor shall include all gross receipts of the taxpayer from sources within this state, including, but not limited to, the following:

1. Gross receipts derived from the sale of tangible personal property, including printed materials, delivered or shipped to a purchaser or a subscriber in this state.

2. Except as provided in subparagraph (3)(iii)B.3., gross receipts derived from advertising and the sale, rental or other use of the taxpayer's customer lists or any portion thereof shall be attributed to this state as determined by the taxpayer's "circulation factor" during the tax period. The circulation factor shall be determined for each individual publication by the taxpayer of printed material containing advertising and shall be equal to the ratio that the taxpayer's in-state circulation to purchasers and subscribers of its printed material bears to its total circulation to purchasers and subscribers everywhere.

The circulation factor for an individual publication shall be determined by reference to the rating statistics as reflected in such sources as Audit Bureau of Circulations or other comparable sources, provided that the source selected is consistently used from year to year for such purpose. If none of the foregoing sources are available, or, if available, none is in form or content sufficient for such purposes, then the circulation factor shall be determined from the taxpayer's books and records.

3. When specific items of advertisements can be shown, upon clear and convincing evidence, to have been distributed solely to a limited regional or local geographic area in which this state is located, the taxpayer may petition, or the [Tax Administrator] may require, that a portion of such receipts be attributed to the sales factor numerator of this state on the basis of a regional or local geographic area circulation factor and not upon the basis of the circulation factor provided by subparagraph (3)(iii)B.2. Such attribution shall be based upon the ratio that the taxpayer's circulation to purchasers and subscribers located in this state of the printed material containing such specific items of advertising bears to its total circulation of such printed material to purchasers and subscribers located within such regional or local geographic area. This alternative attribution method shall be permitted only upon the condition that such receipts are not double counted or otherwise included in the numerator of any other state.

4. In the event that the purchaser or subscriber is the United States Government or that the taxpayer is not taxable in a State, the gross receipts from all sources, including the receipts from the sale of printed material, from advertising, and from the sale, rental or other use of the taxpayer's customer's lists, or any portion thereof that would have been attributed by the circulation factor to the numerator of the sales factor for such State, shall be included in the numerator of the sales factor of this State if the printed material or other property is shipped from an office, store, warehouse, factory, or other place of storage or business in this State.

Recommended Formula for the Apportionment and Allocation Of Net Income of Financial Institutions

Adopted November 17, 1994

Section 1. Apportionment and Allocation.

(a) Except as otherwise specifically provided, a financial institution whose business activity is taxable both within and without this state shall allocate and apportion its net income as provided in this [Act]. All items of nonbusiness income (income which is not includable in the apportionable income tax base) shall be allocated pursuant to the provisions of [ ]. A financial institution organized under the laws of a foreign country, the Commonwealth of Puerto Rico, or a territory or possession of the United States whose effectively connected income (as defined under the Federal Internal Revenue Code) is taxable both within this state and within another state, other than the state in which it is organized, shall allocate and apportion its net income as provided in this [Act].

(b) All business income (income which is includable in the apportionable income tax base) shall be apportioned to this state by multiplying such income by the apportionment percentage. The apportionment percentage is determined by adding the taxpayer's receipts factor (as described in Section 3 of this article), property factor (as described in Section 4 of this article), and payroll factor (as described in Section 5 of this article) together and dividing the sum by three. If one of the factors is missing, the two remaining factors are added and the sum is divided by two. If two of the factors are missing, the remaining factor is the apportionment percentage. A factor is missing if both its numerator and denominator are zero, but it is not missing merely because its numerator is zero.

(c) Each factor shall be computed according to the method of accounting (cash or accrual basis) used by the taxpayer for the taxable year.

(d) If the allocation and apportionment provisions of this [Act] do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the [State Tax Administrator] may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) the exclusion of any one or more of the factors,

(3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Section 2. Definitions.

As used in this [Act], unless the context otherwise requires:

(a) "**Billing address**" means the location indicated in the books and records of the taxpayer on the first day of the taxable year (or on such later date in the taxable year when the customer relationship began) as the address where any notice, statement and/or bill relating to a customer's account is mailed.

(b) "**Borrower or credit card holder located in this state**" means:

(1) a borrower, other than a credit card holder, that is engaged in a trade or business which maintains its commercial domicile in this state; or

(2) a borrower that is not engaged in a trade or business or a credit card holder whose billing address is in this state.

(c) "**Commercial domicile**" means:

(1) the headquarters of the trade or business, that is, the place from which the trade or business is principally managed and directed; or

(2) if a taxpayer is organized under the laws of a foreign country, or of the Commonwealth of Puerto Rico, or any territory or possession of the United States, such taxpayer's commercial domicile shall be deemed for the purposes of this [Act] to be the state of the United States or the District of Columbia from which such taxpayer's trade or business in the United States is principally managed and directed. It shall be presumed, subject to rebuttal, that the location from which the taxpayer's trade or business is principally managed and directed is the state of the United States or the District of Columbia to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employees are performed, as of the last day of the taxable year.

(d) "**Compensation**" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services that are included in such employee's gross income under the Federal Internal Revenue Code. In the case of employees not subject to the Federal Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such payments would constitute gross income to such employees under the Federal Internal Revenue Code shall be made as though such employees were subject to the Federal Internal Revenue Code.

(e) "**Credit card**" means credit, travel or entertainment card.

(f) "**Credit card issuer's reimbursement fee**" means the fee a taxpayer receives from a merchant's bank because one of the persons to whom the taxpayer has issued a credit card has charged merchandise or services to the credit card.

(g) "**Employee**" means, with respect to a particular taxpayer, any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee of that taxpayer.

(h) "**Financial institution**" means: [insert state's definition here][*for a starting point for the development of a definition, see Appendix A*].

(i) "**Gross rents**" means the actual sum of money or other consideration payable for the use or possession of property. "Gross rents" shall include, but not be limited to:

(1) any amount payable for the use or possession of real property or tangible property whether designated as a fixed sum of money or as a percentage of receipts, profits or otherwise,

(2) any amount payable as additional rent or in lieu of rent, such as interest, taxes, insurance, repairs or any other amount required to be paid by the terms of a lease or other arrangement, and

(3) a proportionate part of the cost of any improvement to real property made by or on behalf of the taxpayer which reverts to the owner or lessor upon termination of a lease or other arrangement. The amount to be included in gross rents is the amount of amortization or depreciation allowed in computing the taxable income base for the taxable year. However, where a building is erected on leased land by or on behalf of the taxpayer, the value of the land is determined by multiplying the gross rent by eight and the value of the building is determined in the same manner as if owned by the taxpayer.

(4) The following are not included in the term "gross rents":

(A) reasonable amounts payable as separate charges for water and electric service furnished by the lessor;

(B) reasonable amounts payable as service charges for janitorial services furnished by the lessor;

(C) reasonable amounts payable for storage, provided such amounts are payable for space not designated and not under the control of the taxpayer; and

(D) that portion of any rental payment which is applicable to the space subleased from the taxpayer and not used by it.

(j) "**Loan**" means any extension of credit resulting from direct negotiations between the taxpayer and its customer, and/or the purchase, in whole or in part, of such extension of credit from another. Loans include participations, syndications, and leases treated as loans for federal income tax purposes. Loans shall not include: properties treated as loans under Section 595 of the Federal Internal Revenue Code; futures or forward contracts; options; notional principal contracts such as swaps; credit card receivables, including purchased credit card relationships; non-interest bearing balances due from depository institutions; cash items in the process of collection; federal funds sold; securities purchased under agreements to resell; assets held in a trading account; securities; interests in a REMIC, or other mortgage-backed or asset-backed security; and other similar items.

(k) "**Loan secured by real property"** means that fifty percent or more of the aggregate value of the collateral used to secure a loan or other obligation, when valued at fair market value as of the time the original loan or obligation was incurred, was real property.

(l) "**Merchant discount**" means the fee (or negotiated discount) charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder.

(m)"**Participation**" means an extension of credit in which an undivided ownership interest is held on a *pro rata* basis in a single loan or pool of loans and related collateral. In a loan participation, the credit originator initially makes the loan and then subsequently resells all or a portion of it to other lenders. The participation may or may not be known to the borrower.

(n) "**Person**" means an individual, estate, trust, partnership, corporation and any other business entity.

(o) "**Principal base of operations**" with respect to transportation property means the place of more or less permanent nature from which said property is regularly directed or controlled. With respect to an employee, the "principal base of operations" means the place of more or less permanent nature from which the employee regularly (1) starts his or her work and to which he or she customarily returns in order to receive instructions from his or her employer or (2) communicates with his or her customers or other persons, or (3) performs any other functions necessary to the exercise of his or her trade or profession at some other point or points.

(p) "**Real property owned**" and "**tangible personal property owned**" mean real and tangible personal property, respectively, (1) on which the taxpayer may claim depreciation for federal income tax purposes, or (2) property to which the taxpayer holds legal title and on which no other person may claim depreciation for federal income tax purposes (or could claim

depreciation if subject to federal income tax). Real and tangible personal property do not include coin, currency, or property acquired in lieu of or pursuant to a foreclosure.

(q) "**Regular place of business**" means an office at which the taxpayer carries on its business in a regular and systematic manner and which is continuously maintained, occupied and used by employees of the taxpayer.

(r) "**State**" means a state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States or any foreign country.

(s) "**Syndication**" means an extension of credit in which two or more persons fund and each person is at risk only up to a specified percentage of the total extension of credit or up to a specified dollar amount.

(t) "**Taxable**" means either:

(1) that a taxpayer is subject in another state to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, a corporate stock tax (including a bank shares tax), a single business tax, or an earned surplus tax, or any tax which is imposed upon or measured by net income; or

(2) that another state has jurisdiction to subject the taxpayer to any of such taxes regardless of whether, in fact, the state does or does not.

(u) "**Transportation property**" means vehicles and vessels capable of moving under their own power, such as aircraft, trains, water vessels and motor vehicles, as well as any equipment or containers attached to such property, such as rolling stock, barges, trailers or the like.

Section 3. Receipts Factor.

(a) **General**. The receipts factor is a fraction, the numerator of which is the receipts of the taxpayer in this state during the taxable year and the denominator of which is the receipts of the taxpayer within and without this state during the taxable year. The method of calculating receipts for purposes of the denominator is the same as the method used in determining receipts for purposes of the numerator. The receipts factor shall include only those receipts described herein which constitute business income and are included in the computation of the apportionable income base for the taxable year.

(b) **Receipts from the lease of real property**. The numerator of the receipts factor includes receipts from the lease or rental of real property owned by the taxpayer if the property is located within this state or receipts from the sublease of real property if the property is located within this state.

(c) **Receipts from the lease of tangible personal property**.

(1) Except as described in paragraph (2) of this subsection, the numerator of the receipts factor includes receipts from the lease or rental of tangible personal property owned by the taxpayer if the property is located within this state when it is first placed in service by the lessee.

(2) Receipts from the lease or rental of transportation property owned by the taxpayer are included in the numerator of the receipts factor to the extent that the property is used in this state. The extent an aircraft will be deemed to be used in this state and the amount of receipts that is to be included in the numerator of this state's receipts factor is determined by multiplying all the receipts from the lease or rental of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this state and the denominator of which is the total number of landings of the aircraft. If the extent of the use of any transportation property within this state cannot be determined, then the property will be deemed to be used wholly in the state in which the property has its principal base of operations. A motor vehicle will be deemed to be used wholly in the state in which it is registered.

(d) **Interest from loans secured by real property**.

(1) The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from loans secured by real property if the property is located within this state. If the property is located both within this state and one or more other states, the receipts described in this subsection are included in the numerator of the receipts factor if more than fifty percent of the fair market value of the real property is located within this state. If more than fifty percent of the fair market value of the real property is not located within any one state, then the receipts described in this subsection shall be included in the numerator of the receipts factor if the borrower is located in this state.

(2) The determination of whether the real property securing a loan is located within this state shall be made as of the time the original agreement was made and any and all subsequent substitutions of collateral shall be disregarded.

(e) **Interest from loans not secured by real property**. The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from loans not secured by real property if the borrower is located in this state.

(f) **Net gains from the sale of loans**. The numerator of the receipts factor includes net gains from the sale of loans. Net gains from the sale of loans includes income recorded under the coupon stripping rules of Section 1286 of the Internal Revenue Code.

(1) The amount of net gains (but not less than zero) from the sale of loans secured by real property included in the numerator is determined by multiplying such net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (d) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

(2) The amount of net gains (but not less than zero) from the sale of loans not secured by real property included in the numerator is determined by multiplying such net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (e) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(g) **Receipts from credit card receivables**. The numerator of the receipts factor includes interest and fees or penalties in the nature of interest from credit card receivables and receipts from fees charged to card holders, such as annual fees, if the billing address of the card holder is in this state.

(h) **Net gains from the sale of credit card receivables**. The numerator of the receipts factor includes net gains (but not less than zero) from the sale of credit card receivables multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (g) of this section and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(i) **Credit card issuer's reimbursement fees**. The numerator of the receipts factor includes all credit card issuer's reimbursement fees multiplied by a fraction, the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (g) of this section and the denominator of which is the taxpayer's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(j) **Receipts from merchant discount**. The numerator of the receipts factor includes receipts from merchant discount if the commercial domicile of the merchant is in this state. Such receipts shall be computed net of any cardholder charge backs, but shall not be reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its card holders.

(k) **Loan servicing fees**.

(1) (A) The numerator of the receipts factor includes loan servicing fees derived from loans secured by real property multiplied by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection

(d) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

(B) The numerator of the receipts factor includes loan servicing fees derived from loans not secured by real property multiplied by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to subsection (e) of this section and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(2) In circumstances in which the taxpayer receives loan servicing fees for servicing either the secured or the unsecured loans of another, the numerator of the receipts factor shall include such fees if the borrower is located in this state.

(l) **Receipts from services**. The numerator of the receipts factor includes receipts from services not otherwise apportioned under this section if the service is performed in this state. If the service is performed both within and without this state, the numerator of the receipts factor includes receipts from services not otherwise apportioned under this section, if a greater proportion of the income-producing activity is performed in this state based on cost of performance.

(m) **Receipts from investment assets and activities and trading assets and activities.**

(1) Interest, dividends, net gains (but not less than zero) and other income from investment assets and activities and from trading assets and activities shall be included in the receipts factor. Investment assets and activities and trading assets and activities include but are not limited to: investment securities; trading account assets; federal funds; securities purchased and sold under agreements to resell or repurchase; options; futures contracts; forward contracts; notional principal contracts such as swaps; equities; and foreign currency transactions. With respect to the investment and trading assets and activities described in subparagraphs (A) and (B) of this paragraph, the receipts factor shall include the amounts described in such subparagraphs.

(A) The receipts factor shall include the amount by which interest from federal funds sold and securities purchased under resale agreements exceeds interest expense on federal funds purchased and securities sold under repurchase agreements.

(B) The receipts factor shall include the amount by which interest, dividends, gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, exceed amounts paid in lieu of interest, amounts paid in lieu of dividends, and losses from such assets and activities.

(2) The numerator of the receipts factor includes interest, dividends, net gains (but not less than zero) and other income from investment assets and activities and from trading assets and activities described in paragraph (1) of this subsection that are attributable to this state.

(A) The amount of interest, dividends, net gains (but not less than zero) and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the average value of such assets which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such assets.

(B) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (A) of paragraph (1) of this subsection from such funds and such securities by a fraction, the numerator of which is the average value of federal funds sold and securities purchased under agreements to resell which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such funds and such securities.

(C) The amount of interest, dividends, gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book and foreign currency transactions (but excluding amounts described in subparagraphs (A) or (B) of this paragraph), attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (B) of paragraph (1) of this subsection by a fraction, the numerator of which is the average value of such trading assets which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the average value of all such assets.

(D) For purposes of this paragraph, average value shall be determined using the rules for determining the average value of tangible personal property set forth in subsections (c) and (d) of Section 4.

(3) In lieu of using the method set forth in paragraph (2) of this subsection, the taxpayer may elect, or the [State Tax Administrator] may require in order to fairly represent the business activity of the taxpayer in this state, the use of the method set forth in this paragraph.

(A) The amount of interest, dividends, net gains (but not less than zero) and other income from investment assets and activities in the investment account to be attributed to this state and included in the numerator is determined by multiplying all such income from such assets and activities by a fraction, the numerator of which is the gross income from such assets and activities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

(B) The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (A) of paragraph (1) of this subsection from such funds and such securities by a fraction, the numerator of which is the gross income from such funds and such securities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such funds and such securities.

(C) The amount of interest, dividends, gains and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book and foreign currency transactions (but excluding amounts described in subparagraphs (A) or (B) of this paragraph), attributable to this state and included in the numerator is determined by multiplying the amount described in subparagraph (B) of paragraph (1) of this subsection by a fraction, the numerator of which is the gross income from such trading assets and activities which are properly assigned to a regular place of business of the taxpayer within this state and the denominator of which is the gross income from all such assets and activities.

(4) If the taxpayer elects or is required by the [State Tax Administrator] to use the method set forth in paragraph (3) of this subsection, it shall use this method on all subsequent returns unless the taxpayer receives prior permission from the [State Tax Administrator] to use, or the [State Tax Administrator] requires a different method.

(5) The taxpayer shall have the burden of proving that an investment asset or activity or trading asset or activity was properly assigned to a regular place of business outside of this state by demonstrating that the day-to-day decisions regarding the asset or activity occurred at a regular place of business outside this state. Where the day-to-day decisions regarding an investment asset or activity or trading asset or activity occur at

more than one regular place of business and one such regular place of business is in this state and one such regular place of business is outside this state, such asset or activity shall be considered to be located at the regular place of business of the taxpayer where the investment or trading policies or guidelines with respect to the asset or activity are established. Unless the taxpayer demonstrates to the contrary, such policies and guidelines shall be presumed to be established at the commercial domicile of the taxpayer.

(n) **All other receipts**. The numerator of the receipts factor includes all other receipts pursuant to the rules set forth in [insert your state's regular situsing rules for the receipts not covered by this section].

(o) **Attribution of certain receipts to commercial domicile**. All receipts which would be assigned under this section to a state in which the taxpayer is not taxable shall be included in the numerator of the receipts factor, if the taxpayer's commercial domicile is in this state.

Section 4. Property Factor.

(a) **General**. The property factor is a fraction, the numerator of which is the average value of real property and tangible personal property rented to the taxpayer that is located or used within this state during the taxable year, the average value of the taxpayer's real and tangible personal property owned that is located or used within this state during the taxable year, and the average value of the taxpayer's loans and credit card receivables that are located within this state during the taxable year, and the denominator of which is the average value of all such property located or used within and without this state during the taxable year.

(b) **Property included**. The property factor shall include only property the income or expenses of which are included (or would have been included if not fully depreciated or expensed, or depreciated or expensed to a nominal amount) in the computation of the apportionable income base for the taxable year.

(c) **Value of property owned by the taxpayer**.

(1) The value of real property and tangible personal property owned by the taxpayer is the original cost or other basis of such property for Federal income tax purposes without regard to depletion, depreciation or amortization.

(2) Loans are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a loan is charged-off in whole or in part for Federal income tax purposes, the portion of the loan charged off is not outstanding. A specifically allocated reserve established pursuant to regulatory or financial accounting guidelines which is treated as charged-off for Federal income tax purposes shall be treated as charged-off for purposes of this section.

(3) Credit card receivables are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a credit card receivable is charged-off in whole or in part for Federal income tax purposes, the portion of the receivable charged-off is not outstanding.

(d) **Average value of property owned by the taxpayer**. The average value of property owned by the taxpayer is computed on an annual basis by adding the value of the property on the first day of the taxable year and the value on the last day of the taxable year and dividing the sum by two. If averaging on this basis does not properly reflect average value, the [State Tax Administrator] may require averaging on a more frequent basis. The taxpayer may elect to average on a more frequent basis. When averaging on a more frequent basis is required by the [State Tax Administrator] or is elected by the taxpayer, the same method of valuation must be used consistently by the taxpayer with respect to property within and without this state and on all subsequent returns unless the taxpayer receives prior permission from the [State Tax Administrator] or the [State Tax Administrator] requires a different method of determining average value.

(e) **Average value of real property and tangible personal property rented to the taxpayer**.

(1) The average value of real property and tangible personal property that the taxpayer has rented from another and which is not treated as property owned by the taxpayer for Federal income tax purposes, shall be determined annually by multiplying the gross rents payable during the taxable year by eight.

(2) Where the use of the general method described in this subsection results in inaccurate valuations of rented property, any other method which properly reflects the value may be adopted by the [State Tax Administrator] or by the taxpayer when approved in writing by the [State Tax Administrator]. Once approved, such other method of valuation must be used on all subsequent returns unless the taxpayer receives prior approval from the [State Tax Administrator] or the [State Tax Administrator] requires a different method of valuation.

(f) **Location of real property and tangible personal property owned by or rented to the taxpayer**.

(1) Except as described in paragraph (2) of this subsection, real property and tangible personal property owned by or rented to the taxpayer is considered to be located within this state if it is physically located, situated or used within this state.

(2) Transportation property is included in the numerator of the property factor to the extent that the property is used in this state. The extent an aircraft will be deemed to

be used in this state and the amount of value that is to be included in the numerator of this state's property factor is determined by multiplying the average value of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this state and the denominator of which is the total number of landings of the aircraft everywhere. If the extent of the use of any transportation property within this state cannot be determined, then the property will be deemed to be used wholly in the state in which the property has its principal base of operations. A motor vehicle will be deemed to be used wholly in the state in which it is registered.

(g) **Location of loans**

(1) (A) A loan is considered to be located within this state if it is properly assigned to a regular place of business of the taxpayer within this state.

(B) A loan is properly assigned to the regular place of business with which it has a preponderance of substantive contacts. A loan assigned by the taxpayer to a regular place of business without the state shall be presumed to have been properly assigned if--

(i) the taxpayer has assigned, in the regular course of its business, such loan on its records to a regular place of business consistent with Federal or state regulatory requirements;

(ii) such assignment on its records is based upon substantive contacts of the loan to such regular place of business; and

(iii) the taxpayer uses said records reflecting assignment of loans for the filing of all state and local tax returns for which an assignment of loans to a regular place of business is required.

(C) The presumption of proper assignment of a loan provided in subparagraph (B) of paragraph (1) of this subsection may be rebutted upon a showing by the [State Tax Administrator], supported by a preponderance of the evidence, that the preponderance of substantive contacts regarding such loan did not occur at the regular place of business to which it was assigned on the taxpayer's records. When such presumption has been rebutted, the loan shall then be located within this state if (i) the taxpayer had a regular place of business within this state at the time the loan was made; and (ii) the taxpayer fails to show, by a preponderance of the evidence, that the preponderance of substantive contacts regarding such loan did not occur within this state.

(2) In the case of a loan which is assigned by the taxpayer to a place without this state which is not a regular place of business, it shall be presumed, subject to rebuttal by the taxpayer on a showing supported by the preponderance of evidence, that the preponderance of substantive contacts regarding the loan occurred within this state if, at the time the loan was made the taxpayer's commercial domicile, as defined by subsection (c) of Section 2, was within this state**.**

(3) To determine the state in which the preponderance of substantive contacts relating to a loan have occurred, the facts and circumstances regarding the loan at issue shall be reviewed on a case-by-case basis and consideration shall be given to such activities as the solicitation, investigation, negotiation, approval and administration of the loan. The terms "solicitation", "investigation", "negotiation", "approval" and "administration" are defined as follows:

(A) *Solicitation*. Solicitation is either active or passive. Active solicitation occurs when an employee of the taxpayer initiates the contact with the customer. Such activity is located at the regular place of business which the taxpayer's employee is regularly connected with or working out of, regardless of where the services of such employee were actually performed. Passive solicitation occurs when the customer initiates the contact with the taxpayer. If the customer's initial contact was not at a regular place of business of the taxpayer, the regular place of business, if any, where the passive solicitation occurred is determined by the facts in each case.

(B) *Investigation*. Investigation is the procedure whereby employees of the taxpayer determine the credit-worthiness of the customer as well as the degree of risk involved in making a particular agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(C) *Negotiation*. Negotiation is the procedure whereby employees of the taxpayer and its customer determine the terms of the agreement (e.g., the amount, duration, interest rate, frequency of repayment, currency denomination and security required). Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed.

(D) *Approval*. Approval is the procedure whereby employees or the board of directors of the taxpayer make the final determination whether to enter into the agreement. Such activity is located at the regular place of business which the taxpayer's employees are regularly connected with or working out of, regardless of where the services of such employees were actually performed. If the board of

directors makes the final determination, such activity is located at the commercial domicile of the taxpayer.

(E) *Administration*. Administration is the process of managing the account. This process includes bookkeeping, collecting the payments, corresponding with the customer, reporting to management regarding the status of the agreement and proceeding against the borrower or the security interest if the borrower is in default. Such activity is located at the regular place of business which oversees this activity.

(h) **Location of credit card receivables**. For purposes of determining the location of credit card receivables, credit card receivables shall be treated as loans and shall be subject to the provisions of subsection (g) of this section.

(i) **Period for which properly assigned loan remains assigned.** A loan that has been properly assigned to a state shall, absent any change of material fact, remain assigned to said state for the length of the original term of the loan. Thereafter, said loan may be properly assigned to another state if said loan has a preponderance of substantive contact to a regular place of business there.

Section 5. Payroll Factor.

(a) **General**. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the taxpayer for compensation and the denominator of which is the total compensation paid both within and without this state during the taxable year. The payroll factor shall include only that compensation which is included in the computation of the apportionable income tax base for the taxable year.

(b) **Compensation relating to nonbusiness income and independent contractors**. The compensation of any employee for services or activities which are connected with the production of nonbusiness income (income which is not includable in the apportionable income base) and payments made to any independent contractor or any other person not properly classifiable as an employee shall be excluded from both the numerator and denominator of the factor.

(c) **When compensation paid in this state**. Compensation is paid in this state if any one of the following tests, applied consecutively, is met:

(1) The employee's services are performed entirely within this state.

(2) The employee's services are performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The term "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(3) If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:

(A) if the employee's principal base of operations is within this state; or

(B) if there is no principal base of operations in any state in which some part of the services are performed, but the place from which the services are directed or controlled is in this state; or

(C) if the principal base of operations and the place from which the services are directed or controlled are not in any state in which some part of the service is performed but the employee's residence is in this state.

Appendix A — Definition of Financial Institution.

The following definition of a financial institution or a variation thereof could be made part of a statutory proposal or could be adopted by regulation if the state legislature has already delegated the authority to do so to the State Tax Administrator or other administrative officer. Again, the following provides a *starting point* for discussion purposes, and the lack of a uniformly adopted definition by all of the states, while affecting competitive balance, is not critical to the main thrust of the apportionment proposal.

"**Financial institution**" means:

(1) Any corporation or other business entity registered under state law as a bank holding company or registered under the Federal Bank Holding Company Act of 1956, as amended, or registered as a savings and loan holding company under the Federal National Housing Act, as amended;

(2) A national bank organized and existing as a national bank association pursuant to the provisions of the National Bank Act, 12 U.S.C. §§21 et seq.;

(3) A savings association or federal savings bank as defined in the Federal Deposit Insurance Act, 12 U.S.C.§ 1813(b)(1);

(4) Any bank or thrift institution incorporated or organized under the laws of any state;

(5) Any corporation organized under the provisions of 12 U.S.C. §§611 to 631.

(6) Any agency or branch of a foreign depository as defined in 12 U.S.C. §3101;

(7) A state credit union the loan assets of which exceed $50,000,000 as of the first day of its taxable year;

(8) A production credit association organized under the Federal Farm Credit Act of 1933, all of whose stock held by the Federal Production Credit Corporation has been retired;

(9) Any corporation whose voting stock is more than fifty percent (50%) owned, directly or indirectly, by any person or business entity described in subsections (1) through (8) above other than an insurance company taxable under [insert applicable state statute] or a company taxable under [insert applicable state statute];

(10) A corporation or other business entity that derives more than fifty percent (50%) of its total gross income for financial accounting purposes from finance leases. For purposes of this subsection, a "finance lease" shall mean any lease transaction which is the functional equivalent of an extension of credit and that transfers substantially all of the benefits and risks incident to the ownership of property. The phrase shall include any "direct financing lease" or "leverage lease"

that meets the criteria of Financial Accounting Standards Board Statement No. 13, "Accounting for Leases" or any other lease that is accounted for as a financing by a lessor under generally accepted accounting principles.

For this classification to apply,

(a) the average of the gross income in the current tax year and immediately preceding two tax years must satisfy the more than fifty percent (50%) requirement; and

(b) gross income from incidental or occasional transactions shall be disregarded;

or

(11) Any other person or business entity, other than [an insurance company taxable under _____], [a real estate broker taxable under _____], [a securities dealer taxable under _____] or [a _____ company taxable under _____],which derives more than fifty percent (50%) of its gross income from activities that a person described in subsections (2) through (8) and (10) above is authorized to transact. For the purpose of this subsection, the computation of gross income shall not include income from non-recurring, extraordinary items.

(12) The [State Tax Administrator] is authorized to exclude any person from the application of subsection (11) upon such person proving, by clear and convincing evidence, that the income-producing activity of such person is not in substantial competition with those persons described in subsections (2) through (8) and (10) above.

MODEL STATUTES AND REGULATIONS

Uniform Protest Statute

Adopted August 31, 1990

••• Section 1. Protest of Notice of Assessment [Appeal].

(a) A person aggrieved by a Notice of Assessment [Intent to Assess, Levy, etc.] shall have the right to protest [appeal] such notice only if the protest [appeal] is perfected in full and timely compliance with the requirements contained in subsections (b) and (c) hereof.

(b) The taxpayer shall have thirty (30) days after the date of mailing of the Notice of Assessment [Intent to Assess, Levy, etc.] within which to file a written Notice of Protest [Appeal], signed by the taxpayer or his duly authorized representative, which shall contain the following documents, information and payments:

(1) Taxpayer's name, address, telephone and Social Security or Tax Id. number.

(2) Name, address, and telephone number of taxpayer's representative, if any, for the purposes of the protest. In such case, a written power of attorney shall be filed with the Notice of Protest [Appeal].

(3) Type of tax and tax period(s) under protest.

(4) Amount under protest and amount uncontested.

(5) A copy of the Notice of Assessment at issue.

(6) Taxpayer shall remit the entire uncontested amount of the tax, interest, and penalty, if any, that is due.

(7) Statement of Grounds for Protest [Appeal].

For the purpose of this provision, the date of mailing of the Notice of Assessment shall be determined by the date of the Notice of Assessment or the date of postmark, whichever is later.

(c) The written Statement of Grounds for Protest [Appeal] shall state the specific grounds upon which the protest [appeal] is based and the specific facts supporting each ground asserted. Upon written request made within the time permitted for the filing of the Notice of Protest [Appeal], the taxpayer shall be granted additional time, not to exceed sixty (60) days from the date of the filing of the Notice of Protest [Appeal], within which to file the Statement of Grounds for Protest [Appeal].

(d) If either the Notice of Protest [Appeal] or the Statement of Grounds for Protest [Appeal] is filed by mail, it must be addressed to [Department of Revenue] and the applicable postage paid. The date of the United States postmark will be deemed the date of filing; however, if the filing is accomplished by other than through delivery by the United States Postal Service, the date of actual receipt will be deemed the date of filing.

(e) If the taxpayer fails to fully or timely file either his Notice of Protest [Appeal], along with the entire amount of uncontested tax, interest, and penalty due, or his Statement of Grounds for Protest [Appeal], the protest [appeal] shall be considered as not timely perfected and shall be dismissed. Upon such dismissal, the Notice of Assessment [Intent to Assess, Levy, etc.] shall be final and shall not be reviewable in any court by appeal, mandamus, administrative review, or any other method of direct or collateral attack.

(f) Notwithstanding the foregoing, the taxpayer shall not be precluded from paying the tax, interest and penalty due under the Notice of Assessment and seeking a refund thereof pursuant to § _____ [the state statutory provisions for making payment and applying for refund].[1]

••• Section 2. Penalty for Frivolous Protest.[2]

If a protest [appeal] to the Notice of Assessment [Intent to Assess, Levy, etc.] or any filing or act taken with respect thereto is determined by the [Tax Administrator] to be frivolous or for the purpose to delay or impede the administration of taxes under the act [article, part, etc.], a penalty of $100.00 or 25% of the total amount of tax under protest, whichever is greater, shall be added to the tax.

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[1]Optional provision.

[2]Section 2. represents the statutory language recommended should a state determine to adopt a penalty for the filing of a frivolous protest. The Commission makes no recommendation as to whether a state should or should not adopt such a penalty. However, if such a penalty is adopted by a state, the Commission recommends, for uniformity purposes, that the provision take the form provided.

American Bar Association Section of Taxation
Committee on S Corporations
Subcommittee on the State Taxation of S Corporations
June 1989 (Revised)

Model S Corporation Income Tax Act

Recommended (with Six Proposed Modifications) to the States
by the Multistate Tax Commission, August 2, 1991

I. BASIC PROVISIONS

SECTION 1000. TITLE; DEFINITIONS; FEDERAL CONFORMITY; CONSTRUCTION

(a) The title of this Part shall be the [name of State] S Corporation Income Tax Act.

(b) For purposes of this Part, the following terms shall have the following meanings:

(1) C Corporation: a corporation which is not an S Corporation.

(2) Code: the Internal Revenue Code of 1986, as amended and as applicable to the Taxable Period; references to sections of the Code shall be deemed to refer to corresponding provisions of prior and subsequent federal tax laws.

(3) Income Attributable to the State: items of income, loss, deduction or credit of the S Corporation apportioned to this State pursuant to [Section number—business income apportionment provision] or allocated to this State pursuant to [Section number—nonbusiness income allocation provision].

(4) Income Not Attributable to the State: all items of income, loss, deduction or credit of the S Corporation other than Income Attributable to the State.

(5) Post–Termination Transition Period: that period defined in Section 1377(b)(1) of the Code.

(6) Pro Rata Share: the portion of any item attributable to an S Corporation shareholder for a Taxable Period determined in the manner provided in, and subject to any election made under, Section 1377(a) or 1362(e), as the case may be, of the Code.

(7) S Corporation: a corporation for which a valid election under Section 1362(a) of the Code is in effect.

(8) Taxable Period: any taxable year or portion of a taxable year during which a corporation is an S Corporation.

(c) Except as otherwise expressly provided or clearly appearing from the context, any term used in this Part shall have the same meaning as when used in a comparable context in the Code, or in any statute relating to federal income taxes, in effect for the Taxable Period. Due consideration shall be given in the interpretation of this Part to applicable sections of the Code in effect from time to time and to federal rulings and regulations interpreting such sections, provided such Code, rulings and regulations do not conflict with the provisions of this Part.

(d) This Act shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject matter of this Act among States enacting it.

SECTION 1001. TAXATION OF AN S CORPORATION AND ITS SHAREHOLDERS

(a) [Alternative No. 1] An S Corporation shall not be subject to the tax imposed by [Section number—taxation of C Corporations].

(a) [Alternative No. 2] Except as provided in the following sentence, an S Corporation shall not be subject to the tax imposed by [Section number—taxation of C Corporations]. If an S Corporation is subject to federal income tax on any of its income, then the amount of such income, as modified pursuant to Section 1002 of this Part, that constitutes Income Attributable to the State shall be subject to the tax imposed by [Section number—taxation of C Corporations]. The S Corporations Income Attributable to the State shall be reduced by the amount of any tax imposed on the corporation pursuant to the preceding sentence.

(b) For purposes of [Section number—taxation of individuals], each shareholder's Pro Rata Share of the S Corporation's Income Attributable to the State and each resident shareholder's Pro Rata Share of the S Corporation's Income Not Attributable to the State, as modified pursuant to Section 1002 of this Part, shall be taken into account by the shareholder in the manner provided in Section 1366 of the Code.

(c) For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed on the S Corporation under the Code shall proportionately reduce the S Corporation's Income Attributable to the State and Income Not Attributable to the State.

SECTION 1002. MODIFICATION AND CHARACTERIZATION OF INCOME

(a) An S Corporation's Income Attributable to the State shall, for purposes of Section 1001 of this Part, be subject to the modifications provided in [Section number—corporate modifications].

(b) The Pro Rata Share of each resident shareholder of an S Corporation in the Income Not Attributable to the State shall, for purposes of Section 1001(b) of this Part, be subject to the modifications provided in [Section number—individual modifications].

(c) The character of any S Corporation item taken into account by a shareholder of an S Corporation pursuant to Section 1001(b) of this Part shall be determined as if such item were received or incurred by the S Corporation and not its shareholder.

SECTION 1003. BASIS AND ADJUSTMENTS

(a) The initial basis in the hands of a resident shareholder of an S Corporation in the stock of the S Corporation and any indebtedness of the S Corporation to the shareholder shall be determined in the manner provided under the Code, and shall be determined as of the date (which may be before the effective date of this Part) that is the latest to occur of (1) the date on which the shareholder last became a resident of this State, (2) the date on which the shareholder acquired the stock or the indebtedness of the corporation, or (3) the effective date of the corporation's most recent S election under the Code.

(b) The initial basis of a resident shareholder in the stock and indebtedness of an S Corporation shall be adjusted after the date specified in subsection (a) in the manner and to the extent required by Section 1011 of the Code except that, with respect to any Taxable Period during which the shareholder is a resident of this State—

(1) any modifications made (other than for income exempt from federal or this State's taxation) pursuant to Section 1002 of this Part [(and any provision of prior State law similar to this subsection (b), without regard to subsection (b)(2))] shall be taken into account; and

(2) any adjustments made pursuant to Section 1367 of the Code for a Taxable Period during which this State did not measure the income of a shareholder of an S Corporation by reference to the S Corporation's income shall not be taken into account.

(c) The initial basis in the hands of a nonresident shareholder of an S Corporation in the stock of the S Corporation and any indebtedness of the S Corporation to the shareholder shall be zero as of the date (which may be before the effective date of this Part) that is the latest to occur of (1) the date on which the shareholder last became a nonresident of this State, (2) the date on which the shareholder acquired the stock or the indebtedness of the corporation, or (3) the effective date of the corporation's most recent S election under the Code.

(d) The initial basis of a nonresident shareholder in the stock and indebtedness of an S Corporation shall be adjusted after the date specified in subsection (c) as provided in Section 1367 of the Code, except that such adjustments shall be limited to that portion of the Income Attributable to the State that is taken into account by the shareholder pursuant to Section 1001(b)

of this Part [(and any provision of prior State law similar to this subsection (d))]. In computing Income Attributable to the State for purposes of the preceding sentence, any modification made for income exempt from federal or this State's taxation shall not be taken into account.

(e) The basis in the hands of a resident shareholder of an S Corporation in the stock of the S Corporation shall be reduced by the amount allowed as a loss or deduction pursuant to Section 1004(d) of this Part.

(f) The basis in the hands of a resident shareholder of an S Corporation in the stock of the S Corporation shall be reduced by the amount of any cash distribution which is not taxable to the shareholder as a result of the application of Section 1006(b) of this Part.

(g) For purposes of this section, any person acquiring stock or indebtedness of an S Corporation by gift from a person who is a resident of this State at the time of the gift shall be considered to have acquired the stock or indebtedness at the time the donor acquired the stock or indebtedness.

SECTION 1004. CARRYOVERS AND CARRYBACKS; LOSS LIMITATION

(a) Carryforwards and carrybacks to and from Taxable Periods of an S Corporation shall be restricted in the manner provided in Section 1371(b) of the Code.

(b) The aggregate amount of losses or deductions of an S Corporation taken into account by a shareholder of the S Corporation for a Taxable Period pursuant to Section 1001(b) of this Part shall not exceed the shareholder's combined adjusted basis, determined in accordance with Section 1003 of this Part, in the stock of the S Corporation and any indebtedness of the S Corporation to the shareholder.

(c) Any loss or deduction of an S Corporation which is disallowed for a Taxable Period pursuant to subsection (b) shall be treated as incurred by the corporation in the succeeding Taxable Period with respect to that shareholder.

(d) (1) Any loss or deduction of an S Corporation which is disallowed pursuant to subsection (b) for the corporation's last Taxable Period as an S Corporation shall be treated as incurred by a shareholder on the last day of any Post-Termination Transition Period.

(2) The aggregate amount of losses and deductions taken into account by a shareholder pursuant to subsection (d)(l) shall not exceed the shareholder's adjusted basis in the stock of the corporation (determined in accordance with Section 1003 of this Part at the close of the last day of any Post-Termination Transition Period and without regard to this subsection (d)).

(e)[Optional subsection] Any loss or deduction of an S Corporation for a Taxable Period that is not taken into account by a shareholder of the S Corporation pursuant to [Section numbers—at-risk, passive loss, etc. limitations] shall be treated as incurred by the corporation in the succeeding Taxable Period with respect to that shareholder.

SECTION 1005. PART-YEAR RESIDENCE

For purposes of this Part, if a shareholder of an S Corporation is both a resident and nonresident of this State during any Taxable Period, the shareholder's Pro Rata Share of the S Corporation's Income Attributable to the State and Income Not Attributable to the State for the Taxable Period shall be further prorated between the shareholder's periods of residence and nonresidence during the Taxable Period, in accordance with the number of days in each period.

SECTION 1006. DISTRIBUTIONS

(a) Subject to subsection (c), a distribution made by an S Corporation with respect to its stock to a resident shareholder shall be taken into account by the shareholder for purposes of [Section number—taxation of individuals] to the extent that the distribution is treated as a dividend or as gain from the sale or exchange of property pursuant to Section 1368 of the Code.

(b) Subject to subsection (c), a distribution of money made by a corporation with respect to its stock to a resident shareholder during a Post-Termination Transition Period shall not be taken into account by the shareholder for purposes of [Section number—taxation of individuals] to the extent the distribution is applied against and reduces the adjusted basis of the stock of the shareholder in accordance with Section 1371(e) of the Code.

(c) In applying Sections 1368 and 1371(e) of the Code to any distribution referred to in subsection (a) or (b)—

(1) the term "adjusted basis of the stock" shall mean the shareholder's adjusted basis in the stock of the S Corporation, as determined under Section 1003 of this Part; and

(2) the term "accumulated adjustments account" shall mean an amount that is equal to, and adjusted in the same manner as, the S Corporation's accumulated adjustments account defined in Section 1368(e)(1)(A) of the Code, except that any modifications required to be made pursuant to Section 1002(a) of this Part shall be taken into account.

SECTION 1007. RETURNS; SHAREHOLDER AGREEMENTS; MANDATORY PAYMENTS

(a) An S Corporation which engages in activities in this State which would subject a C Corporation to the requirement to file a return under [Section number—taxation of C Corporations] shall file with the [State taxing authority] an annual return, in the form prescribed by the [State taxing authority], on or before the due date prescribed for the filing of C Corporation returns under [Section number—corporate tax return filing date]. The return shall set forth the name, address and social security or federal identification number of each shareholder; the Income Attributable to the State and Income Not Attributable to the State with respect to each shareholder as determined under this Part; the modifications required by Section 1002 of this Part; and such other information as the [State taxing authority] may by regulation prescribe. The S Corporation shall, on or before the day on which such return is filed, furnish to each person who was a shareholder during the year a copy of such information shown on the return as the [State taxing authority] may by regulation prescribe. The S Corporation shall also maintain the accumulated adjustments account described in Section 1006(c)(2) of this Part.

(b) The [State taxing authority] shall permit S Corporations to file composite returns and to make composite payments of tax on behalf of some or all of its nonresident shareholders. The [State taxing authority] may permit composite returns and payments to be made on behalf of resident shareholders.

(c) With respect to each of its nonresident shareholders, an S Corporation shall for each Taxable Period either (1) timely file with the [State taxing authority] an agreement as provided in subsection (d) or (2) make a payment to this State as provided in subsection (e). An S Corporation that timely files an agreement as provided in subsection(d) with respect to a nonresident shareholder for a Taxable Period shall be considered to have timely filed such an agreement for each subsequent Taxable Period. An S Corporation that does not timely file such an agreement for a Taxable Period shall not be precluded from timely filing such an agreement for subsequent Taxable Periods.

(d) The agreement referred to in subsection (c)(1) is an agreement of a non-resident shareholder of the S Corporation—

(1) to file a return in accordance with the provisions of [Section number—individual tax return filing requirement] and to make timely payment of all taxes imposed on the shareholder by this State with respect to the income of the S Corporation; and

(2) to be subject to personal jurisdiction in this State for purposes of the collection of income taxes, together with related interest and penalties, imposed on the shareholder by this State with respect to the income of the S Corporation.

The agreement will be considered to be timely filed for a Taxable Period (and for all subsequent Taxable Periods) if it is filed at or before the time the annual return for such Taxable Period is required to be filed pursuant to subsection (a).

(e)The payment referred to in subsection (c)(2) shall be in an amount equal to the highest marginal tax rate in effect under [Section number—individual tax rates] multiplied by the shareholder's Pro Rata Share of the Income Attributable to the State reflected on the corporation's return for the Taxable Period. An S Corporation shall be entitled to recover a payment made pursuant to the preceding sentence from the shareholder on whose behalf the payment was made. Any such payment for a Taxable Period must be made at or before the time the annual return for such Taxable Period is required to be filed pursuant to subsection (a).

(f) Any amount paid by the corporation to this State pursuant to subsection (b) or (e) shall be considered to be a payment by the shareholder on account of the income tax imposed on the shareholder for the Taxable Period pursuant to [Section number—taxation of individuals].

SECTION 1008. TAX CREDITS

(a) For purposes of [Section number—individual tax credit allowance provisions], each resident shareholder shall be considered to have paid a tax imposed on the shareholder in an amount equal to the shareholder's Pro Rata Share of any net income tax paid by the S Corporation to a State which does not measure the income of shareholders of an S Corporation by reference to the income of the S Corporation. For purposes of the preceding sentence, the term "net income tax" means any tax imposed on or measured by a corporation's net income.

(b) [Optional] Each shareholder of an S Corporation shall be allowed a credit against the tax imposed by [Section number—taxation of individuals] in an amount equal to the shareholder's Pro Rata Share of the tax credits described in [Section number—policy tax credits available to a C Corporation].

II. ADDENDUM: CONFORMING PROVISIONS

A. LIFO RECAPTURE (OPTIONAL)

If a corporation is subject to LIFO recapture pursuant to Section 1363(d) of the Code, then—

(1) any increase in the tax imposed by [Section number—taxation of C Corporations] by reason of the inclusion of the LIFO recapture amount in its income shall be payable in four equal installments;

(2) the first installment shall be paid on or before the due date (determined without regard to extensions) for filing the return for the first taxable year for which the corporation was subject to the LIFO recapture;

(3) the three succeeding installments shall be paid on or before the due date (determined without regard to extensions) for filing the corporation's return for the three succeeding taxable years; and

(4) for purposes of computing interest on underpayments, the last three installments shall not be considered underpayments until after the payment due date specified above.

B. SAMPLE INDIVIDUAL INCOME TAX PROVISION

[To be inserted in the section determining State taxable income of individuals]

Notwithstanding any other provision of this statute [or other statute designation], a shareholder of an S Corporation (as defined in Section 1000(b)(7)) shall take into account the income, loss, deduction or credit of the S Corporation only to the extent provided in Section 1001(b).

C. SAMPLE CORPORATE INCOME TAX PROVISIONS

[Alternative A—to be inserted in the section determining State taxable income of corporations when an S Corporation is never subject to income tax]

Notwithstanding any other provision of this statute [or other statute designation], an S Corporation (as defined in Section 1000(b)(7)) shall not be subject to the income tax imposed under this section.

[Alternative B—to be inserted in the section determining State taxable income of corporations when an S Corporation will be subject to income tax]

Notwithstanding any other provision of this statute [or other statute designation], an S Corporation (as defined in Section 1000(b)(7)) shall be taxed on its income only to the extent provided in Section 1001(a).

Six Proposed Modifications to The American Bar Association Model S Corporation Income Tax Act

[Note that the Six Proposed Modifications contained in this document have been developed to suggest amendatory language to states considering the American Bar Association Model S Corporation Income Tax Act that would be consistent with* existing *state tax policy. In this sense, an adopting state is not encouraged to adopt any of the Six Proposed Modifications unless the modification being considered is consistent with* existing *state tax policy of the state and the adopting state wishes to preserve the* existing *policy choice represented by one or more of the Six Proposed Modifications.]

PROPOSED MODIFICATION #1

(Accommodating state restrictions against incorporation of the Internal Revenue Code *in futuro*)

Original Draft: Section 1000(b)(2)--

> Code: the Internal Revenu_?e Code of 1986, as amþed and as applicable to the Taxable Period; reference to sections of the Code shall be deemed to refer to corresponding provisions of prior and subsequent federal tax laws.

Original Draft: Section 1000(c)--

> Except as otherwise expressly provided or clearly appearing from the context, any term used in this Part shall have the same meaning as when used in a comparable context in the Code, or in any statute relating to federal income taxes, in effect for the Taxable Period. Due consideration shall be given in the interpretation of this Part to applicable sections of the Code in effect from time to time and to federal rulings and regulations interpreting such sections, provided such Code, rulings and regulations do not conflict with the provisions of this Part.

Optional Draft: Section 1000(b)(2) [MTC Alternative]--

> Code: the Internal Revenue Code of 1986, as amended and as applicable to the Taxable Period pursuant to [Section number--state provision conforming state tax laws to the Internal Revenue Code as of a specified date including to the extent noted provisions amended, deleted, or added thereto prior to the applicable effective date].

Optional Draft: Section 1000(c) [MTC Alternative]--

Except as otherwise expressly provided in this Part or other applicable law or clearly appearing from the context, any term used in this Part shall have the same meaning as when used in a comparable context in the Code, or in any statute relating to federal income taxes, in effect for the Taxable Period pursuant to [Section number--state provision conforming state tax laws to the Internal Revenue Code as of a specified date including to the extent noted provisions amended, deleted, or added thereto prior to the applicable effective date]. Due consideration shall be given in the interpretation of this Part to analogous sections of the Code and to federal rulings and regulations interpreting such sections, provided such Code, rulings and regulations do not conflict with the provisions of this Part.

PROPOSED MODIFICATION #2

(Permitting entity level taxation by states in addition to the taxation of federal built-in gains and excessive passive net income)

Original Draft: Section 1001(a) [Alternative No. 2]--

Except as provided in the following sentence, an S Corporation shall not be subject to the tax imposed by [Section number--taxation of C corporations]. If an S Corporation is subject to federal income tax on any of its income, then the amount of such income, as modified pursuant to Section 1002 of this Part, that constitutes Income Attributable to the State shall be subject to the tax imposed by [Section number--taxation of C corporations]. The S Corporations Income Attributable to the State shall be reduced by the amount of any tax imposed on the corporation pursuant to the preceding sentence.

Optional Draft A: Section 1001(a) [MTC Alternative A] --

An S Corporation's Income Attributable to the State shall be subject to the tax imposed by [Section number--special tax on the income of S Corporations] and, for purposes of determining the amounts taken into account by the shareholder of an S Corporation pursuant to subsection (b), the amount of the tax shall reduce the S Corporation's Income Attributable to the State. An S corporation shall not be subject to the tax imposed by [Section number--taxation of C Corporations].

Optional Draft B: Section 1001(a) [MTC Alternative B]--

An S Corporation shall not be subject to the tax imposed by [Section number--taxation of C Corporations], except:

(1) If an S Corporation is subject to federal income tax on any of its income, then the amount of such income, as modified pursuant to Section 1002 of this Part, that constitutes Income Attributable to the State shall be subject to the tax imposed by [Section number--taxation of C Corporations].

(2) An S Corporation's Income Attributable to the State, less the amount of income subject to the tax imposed under paragraph (1) of this subsection, shall be subject to the tax imposed by [Section number--special tax on income of S Corporations].

For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed pursuant to this subsection shall reduce the S Corporation's Income Attributable to the State.

PROPOSED MODIFICATION #3

(Providing for an alternative which denies resident shareholder credit for entity-level tax imposed by non-recognition state)

Original Draft: Section 1008(a)--

For purposes of [Section number--individual tax credit allowance provisions], each resident shareholder shall be considered to have paid a tax imposed on the shareholder in an amount equal to the shareholder's Pro Rata Share of any net income tax paid by the S Corporation to a state which does not measure the income of shareholders of an S Corporation by reference to the income of the S Corporation. For purposes of the preceding sentence, the term "net income tax" means any tax imposed on or measured by a corporation's net income.

Optional Draft: Section 1008(a) [MTC Alternative]--

For purposes of [Section number--individual tax credit allowance provisions], a net income tax imposed on an S Corporation by another state shall not be creditable against the shareholder's tax liability.

PROPOSED MODIFICATION #4

(Providing for an alternative that prevents an automatic deduction of another state's income taxes by reason of the operation of IRC § 164)

Original Draft: Section 1002(b)--

The Pro Rata Share of each resident shareholder of an S Corporation in the Income Not Attributable to the State shall, for purposes of Section 1001(b) of this Part, be subject to the modifications provided in [Section number--individual modifications].

Optional Draft: Section 1002(b) [MTC Alternative]--

The Pro Rata Share of each resident shareholder of an S Corporation in the Income Not Attributable to the State shall, for purposes of Section 1001(b) of this Part, be--

(1) subject to the modifications provided in [Section number--individual modifications]; and

(2) increased by the amount of the shareholder's Pro Rata Share of any income tax imposed on the corporation by another state.

PROPOSED MODIFICATION #5

(Alternative provision which prohibits reduction of state taxable income passed through to the shareholders for federal Code Section 1374 and 1375 taxes imposed on the corporation.)

Original Draft: Section 1001(c)--

For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed on the S Corporation under the Code shall proportionately reduce the S Corporation's Income Attributable to the State and Income Not Attributable to a State.

Optional Draft: Section 1001(c) [MTC Alternative]--

For purposes of determining the amounts taken into account by the shareholders of an S Corporation pursuant to subsection (b), the amount of any tax imposed on the S Corporation under the Code shall not reduce the S Corporation's Income Attributable to the State and Income Not Attributable to a State.

PROPOSED MODIFICATION #6

(Optional provision requiring informational return to be filed by S Corporation in states where it has resident shareholders even though S Corporation does not operate within such state)

Original Draft: Section 1007(a)--

> An S Corporation which engages in activities in this State which would subject a C Corporation to the requirement to file a return under [Section number--taxation of C Corporation] shall file with the [State taxing authority] an annual return, in the form prescribed by the [State taxing authority], on or before the due date prescribed for the filing of C Corporation returns under [Section number--corporate tax return filing date]. The return shall set forth the name, address and social security or federal identification number of each shareholder; the Income Attributable to the State and Income Not Attributable to the State with respect to each shareholder as determined under this Part; the modifications required by Section 1002 of this Part; and such other information as the [State taxing authority] may by regulations prescribe. The S Corporation shall, on or before the day on which such return is filed, furnish to each person who was a shareholder during the year a copy of such information shown on the return as the [State taxing authority] may by regulation prescribe. The S Corporation shall also maintain the accumulated adjustments account described in Section 1006(c)(2) of this Part.

Optional Draft: Section 1007(a) [MTC Alternative]--

> Every S Corporation which engages in activities in this State which would subject a C Corporation to the requirement to file a return under [Section number--taxation of C Corporation] or which has a shareholder resident in this state shall file with the [State taxing authority] an annual return, in the form prescribed by the [State taxing authority], on or before the due date prescribed for the filing of C Corporation returns under [Section number--corporate tax return filing date]. The return shall set forth the name, address, social security or federal identification number, and last known address or residence of each shareholder; the Income Attributable to the State and Income Not Attributable to the State with respect to each shareholder as determined under this Part; the modifications required by Section 1002 of this Part; and such other information as the [State taxing authority] may by regulations prescribe. The S Corporation shall, on or before the day on which such return is filed, furnish to each person who was a shareholder during the year a copy of such information shown on the return as the [State taxing authority] may by regulation prescribe. The S Corporation shall also maintain the accumulated adjustments account described in Section 1006(c)(2) of this Part.

Uniform Principles Governing State Transactional Taxation of Telecommunications—Vendee Version

Adopted July 30, 1993

INTRODUCTORY NOTE

This uniformity recommendation proposes uniform principles to govern state transactional taxation of *basic* telecommunication services, as distinguished from *enhanced* services. The uniformity recommendation does not advise or endorse (i) the adoption of a state transactional tax on the provision of telecommunications of any type; (ii) the limitation of any adopted state transactional tax on telecommunications to basic, as distinguished from enhanced, telecommunication services, should a State impose a transactional tax on the provision of any telecommunications; or (iii) the implementation of any adopted state transactional tax on telecommunications either as a special industry (telecommunications) excise tax or as an integral part of a general sales and use tax. These policy choices remain within the sovereign discretion of the adopting States. The uniformity recommendation reflects principles thought to be applicable to transactional taxation of the provision of telecommunications regardless of the form of transactional tax implemented.

The uniformity recommendation contains some provisions that are expressed as alternatives. The options afforded by these alternatives are labeled by number, so that an adopting State may relate an alternative change in one portion of the recommendation that requires a correlative change in another part of the recommendation if the alternative is adopted. The included alternatives do not affect the core provisions of the recommendation and are included to provide possible language for States desiring to modify the uniformity recommendation in discrete areas.

The uniformity recommendation is presented in statutory form to facilitate understanding of the intended effect of the recommendation. As a statute, the recommendation contains general provisions that necessarily apply to transactional taxation of other segments of a State's economy in addition to telecommunications. *See*, for example, the definition of "person" in the recommendation. Inclusion of these generally applicable provisions in the recommendation does not suggest that an adopting State should abandon its own currently effective provisions, if a State is satisfied that they adequately serve the State's purposes and the State's provisions are consistent with the results to be achieved by the recommendation.

Uniform Principles Governing State Transactional Taxation of Telecommunications—Vendee Version

1. Definitions.

As used in this [identify adopting State's codified law where the uniform principles are to be placed], unless the context clearly requires otherwise:

(a) "Bad debts" means any portion of a debt related to a sale of intrastate, interstate, or international telecommunication, the gross revenue for which is not otherwise deductible or excludable, that has become worthless or uncollectible, as determined under applicable federal income tax standards. If the portion of the debt deemed to be bad is subsequently paid, the retailer shall report and pay the tax on that portion during the reporting period in which the payment is made.

(b) "Department" means _____.

(c) "Director" means _____.

(d) "Gross revenue" means, subject to the exclusions of this §1(d), the amount charged or paid for the purchase of intrastate, interstate, and international telecommunication. Gross revenue is expressed and valued in money, whether the amount charged is paid in money or otherwise, and includes cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunication, the cost of materials used, labor or service costs or any other expense whatsoever. **Alternative #1:**[In case credit is extended, the amount thereof shall be included only as and when paid.]**:Alternative #1.** Gross revenue for private line services includes charges imposed at each channel termination point within this State, charges for the total channel mileage between each channel termination point within this State, and fifty percent (50%) of charges for the interstate inter-office channel provided between the last channel termination point in this State and the first channel termination point outside of this State. However, gross revenue shall not include:

(1) Any charges or amounts paid that are (i) the tax imposed by this Act; **Alternative #2:**[or]**:Alternative #2.** (ii) the tax imposed by Section 4251 of the Internal Revenue Code, 26 U.S.C. §4251; **Alternative #2:**[or (iii) surcharges imposed by statute, ordinance or regulatory authority for the purpose of financing programs such as assistance to the economically disadvantaged (TAP), 911, TDD, or similar programs developed and financed through surcharges on telecommunications.]**:Alternative #2.**

(2) Charges or amounts paid for customer equipment, including such equipment that is leased or rented by the customer from any source, where such charges or amounts paid are disaggregated and separately identified from other amounts charged or paid for the provision of intrastate, interstate, and international telecommunications.

(3) Charges or amounts paid that are for the sale of property or any service that is provided by an information provider where such charges or amounts paid are disaggregated from the amount charged or paid for the provision of intrastate, interstate, and international telecommunications**Alternative #3:**[; *provided, however*, charges or amounts paid for services that are entirely ancillary to the provision of telecommunications, such as services for telephone directory information, connection or disconnection, calls forwarding, caller-identification, calls waiting, and the like, are not excluded from gross revenue]**:Alternative #3.**. An information provider is a person who provides information, services or products, either through prerecorded or interactive means, utilizing a network of telecommunications to provide the same.

Alternative #4 &/or #5:[And,]**:Alternative #4 &/or #5.**

(4) Bad debts.

Alternative #4:[(5) Charges or amounts paid by direct deposits of money into a telecommunication device requiring such direct deposits in order to operate.]**Alternative #4.**

Alternative #4 &/or #5:[And,]**:Alternative #4 &/or #5.**

Alternative #5:[(6) [Specify other exclusions, if any, to be provided by the adopting State.]]**:Alternative #5.**

(e) "Intrastate telecommunication" means all telecommunications regardless of routing that both originate and terminate within this State.

(f) "Interstate telecommunication" means all telecommunications that either (i) originate in this State and terminate in another State or (ii) originate in another State and terminate in this State, where, in either instance, a service address of the telecommunication is in this State.

(g) "International telecommunication" means all telecommunications that either (i) originate in this State and terminate outside of the United States or (ii) originate outside of the United States and terminate in this State, where, in either instance, a service address of the telecommunication is in this State.

(h) "Person" means, without limitation, any natural individual, firm, trust, estate, partnership, association, joint stock company, joint venture, limited liability company, corporation, cooperative, Indian tribe, or receiver, trustee, guardian or other representative appointed by order of any court, the federal and state governments, governmental instrumentalities, including, without limitation, federal or state universities created by statute, and any political subdivisions of a State.

(i) "Purchase at retail" means the acquisition, consumption or use of telecommunication, provided that purchasing at retail does not include (i) the provision of telecommunications among members of an affiliated group of entities by a member of the group for their own exclusive use and consumption; and (ii) carrier access charges, right of access charges, charges for use of intercompany facilities, and charges for all telecommunications resold in the subsequent provision of telecommunications, all of which charges are non-taxable sales for resale. For purposes of applying clause (i), members of an affiliated group include a parent entity and all of the parent entity's wholly owned entities, including wholly owned, sub-tier entities; and "entity" means a non-natural person. For purposes of applying clause (ii), the following are not sales for resale: the acquisition of telecommunications by the member of the group providing the telecommunications to an affiliated group of entities within the meaning of clause (i); and the acquisition of telecommunications by a provider of enhanced services, even when the cost of the telecommunications is separately stated to the purchaser of the enhanced services, as long as the primary object of the purchase of the telecommunications by the provider is the provision of enhanced services and not telecommunications.

(j) "Private line" means a dedicated, non-traffic sensitive, service for a single customer that entitles the customer to the exclusive or priority use of a communications channel or group of channels from one or more specified locations to one or more specified locations.

(k) "Retailer" means and includes every person engaged in the business of making sales of intrastate, interstate, or international telecommunication.

(l) "Sale of intrastate, interstate, or international telecommunication" means the transmitting, supplying or furnishing of intrastate, interstate, or international telecommunication, respectively, and all services and equipment provided in connection therewith for a consideration to persons other than the federal and state governments, federal and state universities created by statute, and federal governmental instrumentalities which may not be subjected to a state transactional tax on telecommunications under applicable law.

(m) "Service address" means the location of the telecommunication equipment from which the telecommunication is originated or at which the telecommunication is received by a taxpayer. The foregoing rule is amplified, but not limited, by the following special provisions, which are listed in order of priority of application so that only the first applicable special provision will apply, if more than one potentially applies: (i) if the gross revenue is paid through a credit or payment mechanism that does not relate to a service address of the interstate or international telecommunication (as may be the case when payment of the gross revenue is accomplished by a bank, travel, credit or debit card or when the telecommunication is charged to telecommunication equipment whose location does not constitute a service address of the telecommunication), the service address is deemed to be the location of the origination of the interstate or international telecommunication; (ii) if the service address is not a defined location, as in the case of mobile telephones, paging systems, maritime systems, air-to-ground systems and the like, service address shall mean the location of the subscriber's primary use of the telecommunication equipment as defined by telephone number, authorization code, or location in

this State where bills are sent, *provided, however*, the location of the mobile telephone switching office or similar facility in this State that receives and transmits the signals of the telecommunication will be deemed the service address when the mobile telephone switching office or similar facility is outside the subscriber's assigned service area; and (iii) the service address of private line telecommunication services is deemed to be in this State to the extent gross revenues of such services are attributed to this State.

(n) "State" means either this State or any other State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States.

(o) "Taxpayer" means a person who individually or through agents, employees, independent contractors, officers, representatives, or permittees originates or receives intrastate, interstate, or international telecommunications and who incurs a tax liability under this Act.

(p) "Telecommunication," subject to the exclusions stated in this §1(p), includes, without limitation,

(1) any one way transmission or any two way, interactive transmission of sounds, signals, or other intelligence converted to like form, which effect or are intended to effect meaningful communications by electronic or electromagnetic means via wire, cable, satellite, light waves, microwaves, radio waves or otherwise;

(2) the transmission of messages, programming or information through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunication services; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages, programming or information by electronic or similar means between or among points by wire, cable, fiber-optic, laser, microwave, radio, satellite or similar facilities.

Notwithstanding the foregoing definition of this §1(p), telecommunication does not include enhanced services that are defined as services that employ computer processing applications to act on the format, content, code, or protocol or similar aspects of the information to be transmitted, provide additional, different, or restructured information, or involve the taxpayer's interaction with stored information. Under this exception, telecommunication does not include the use of equipment based upon lease or time-sharing agreements, storage of data or information for subsequent retrieval on equipment, or processing of data or information by equipment. Equipment includes, but is not limited to, calculators, computers, data processing equipment, tabulating equipment, or accounting equipment.

2. Imposition of tax-Credit-Exemptions.

(a) A tax is imposed upon the purchase at retail of intrastate, interstate, and international telecommunication by a person where the sale of the intrastate, interstate, and international tele-

communication is charged to the taxpayer's service address in this State at the rate of __% of the gross revenue for such telecommunication.

(b) To prevent actual multijurisdictional taxation of purchases subject to tax under this Act, any taxpayer, upon proof that taxpayer or the taxpayer's seller has previously paid the same tax in another State on such purchase, shall be allowed a credit against the tax imposed to the extent of the amount of such tax legally imposed in such other State, *provided, however,* the amount of credit will not exceed the tax owed to this State on such purchase.

(c) However, the tax is not imposed to the extent that the purchase of intrastate, interstate, and international telecommunications may not, under the Constitution, statutes, or treaties of the United States, be made the subject of transactional taxation by this State. Any taxpayer claiming exemption from the tax by reason of the Constitution, statutes, or treaties of the United States shall file with the Director such claim of exemption as may be prescribed by rule or regulation.

3. Collection of tax

The tax imposed hereunder shall be collected from the taxpayer by the retailer making sales of intrastate, interstate, or international telecommunications and remitted to the Department pursuant to this §3. The tax required to be collected by this Act and any such tax collected by such retailer shall constitute a debt owed by the retailer to this State. Retailers shall collect the tax from the taxpayer by adding the tax to the gross revenue for originating from, or receiving at, a service address in this State intrastate, interstate, or international telecommunications, when sold for use, in the manner prescribed by the Department. Whenever possible, the tax imposed by this Act shall, when collected, be stated as a distinct item separate and apart from the gross revenue for telecommunications. **Alternative #4:** [In the case of telecommunication devices requiring the direct deposits of money to operate, the tax collections may be combined with the charge for the service. If the tax imposed by this Act is paid by direct deposit of money in telecommunication devices requiring such direct deposits, the tax shall be computed each time money is directly deposited in the telecommunication device.]**: Alternative #4.** The tax imposed by this Act shall constitute a debt of the purchaser to the retailer who provides such taxable services until paid, and, if unpaid, is recoverable at law in the same manner as the original charge for such taxable services.

Uniform Principles Governing State Transactional Taxation of Telecommunications—Vendor Version

Adopted July 30, 1993

INTRODUCTORY NOTE

This uniformity recommendation proposes uniform principles to govern state transactional taxation of *basic* telecommunication services, as distinguished from *enhanced* services. The uniformity recommendation does not advise or endorse (i) the adoption of a state transactional tax on the provision of telecommunications of any type; (ii) the limitation of any adopted state transactional tax on telecommunications to basic, as distinguished from enhanced, telecommunication services, should a State impose a transactional tax on the provision of any telecommunications; or (iii) the implementation of any adopted state transactional tax on telecommunications either as a special industry (telecommunications) excise tax or as an integral part of a general sales and use tax. These policy choices remain within the sovereign discretion of the adopting States. The uniformity recommendation reflects principles thought to be applicable to transactional taxation of the provision of telecommunications regardless of the form of transactional tax implemented.

The uniformity recommendation contains some provisions that are expressed as alternatives. The options afforded by these alternatives are labeled by number, so that an adopting State may relate an alternative change in one portion of the recommendation that requires a correlative change in another part of the recommendation if the alternative is adopted. The included alternatives do not affect the core provisions of the recommendation and are included to provide possible language for States desiring to modify the uniformity recommendation in discrete areas.

The uniformity recommendation is presented in statutory form to facilitate understanding of the intended effect of the recommendation. As a statute, the recommendation contains general provisions that necessarily apply to transactional taxation of other segments of a State's economy in addition to telecommunications. *See*, for example, the definition of "person" in the recommendation. Inclusion of these generally applicable provisions in the recommendation does not suggest that an adopting State should abandon its own currently effective provisions, if a State is satisfied that they adequately serve the State's purposes and the State's provisions are consistent with the results to be achieved by the recommendation.

Uniform Principles Governing State Transactional Taxation of Telecommunications—Vendor Version

1. Definitions.

As used in this [identify adopting State's codified law where the uniform principles are to be placed], unless the context clearly requires otherwise:

(a) "Bad debts" means any portion of a debt related to a sale of intrastate, interstate, or international telecommunication, the gross revenue for which is not otherwise deductible or excludable, that has become worthless or uncollectible, as determined under applicable federal income tax standards. If the portion of the debt deemed to be bad is subsequently paid, the taxpayer shall report and pay the tax on that portion during the reporting period in which the payment is made.

(b) "Department" means _____.

(c) "Director" means _____.

(d) "Gross revenue" means, subject to the exclusions of this §1(d), the amount charged for the sale of intrastate, interstate, and international telecommunication. Gross revenue is expressed and valued in money, whether the amount charged is paid in money or otherwise, and includes cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunication, the cost of materials used, labor or service costs or any other expense whatsoever. **Alternative #1:**[In case credit is extended, the amount thereof shall be included only as and when paid.]**:Alternative #1.** Gross revenue for private line services includes charges imposed at each channel termination point within this State, charges for the total channel mileage between each channel termination point within this State, and fifty percent (50%) of charges for the interstate inter-office channel provided between the last channel termination point in this State and the first channel termination point outside of this State. However, gross revenue shall not include:

(1) Any charges for (i) reimbursement of the tax imposed by this Act; **Alternative #2:**[or]**:Alternative #2.** (ii) the tax imposed by Section 4251 of the Internal Revenue Code, 26 U.S.C. §4251; **Alternative #2:**[or (iii) surcharges imposed by statute, ordinance or regulatory authority for the purpose of financing programs such as assistance to the economically disadvantaged (TAP), 911, TDD, or similar programs developed and financed through surcharges on telecommunications.]**:Alternative #2.**

(2) Charges for customer equipment, including such equipment that is leased or rented by the customer from any source, where such charges are disaggregated and separately identified from other amounts charged for the provision of intrastate, interstate, and international

telecommunications.

(3) Charges that are for the sale of property or any service that is provided by an information provider where such charges are disaggregated from the amount charged for the provision of intrastate, interstate, and international telecommunications**Alternative #3:**[; *provided, however*, charges for services that are entirely ancillary to the provision of telecommunications, such as services for telephone directory information, connection or disconnection, calls forwarding, caller-identification, calls waiting, and the like, are not excluded from gross revenue]**:Alternative #3.** An information provider is a person who provides information, services or products, either through prerecorded or interactive means, utilizing a network of telecommunications to provide the same.

Alternative #4 &/or #5:[And,]**:Alternative #4 &/or #5.**

(4) Bad debts.

Alternative #4:[(5) Charges or amounts paid by direct deposits of money into a telecommunication device requiring such direct deposits in order to operate.]**Alternative #4.**

Alternative #4 &/or #5:[And,]**:Alternative #4 &/or #5.**

Alternative #5:[(6) [Specify other exclusions, if any, to be provided by an adopting State.]]**:Alternative #5.**

(e) "Intrastate telecommunication" means all telecommunications regardless of routing that both originate and terminate within this State.

(f) "Interstate telecommunication" means all telecommunications that either (i) originate in this State and terminate in another State or (ii) originate in another State and terminate in this State, where, in either instance, a service address of the telecommunication is in this State.

(g) "International telecommunication" means all telecommunications that either (i) originate in this State and terminate outside of the United States or (ii) originate outside of the United States and terminate in this State, where, in either instance, a service address of the telecommunication is in this State.

(h) "Person" means, without limitation, any natural individual, firm, trust, estate, partnership, association, joint stock company, joint venture, limited liability company, corporation, cooperative, Indian tribe, or receiver, trustee, guardian or other representative appointed by order of any court, the federal and state governments, governmental instrumentalities, including, without limitation, federal or state universities created by statute, and any political subdivisions of a State, and foreign governments, including their political

subdivisions, instrumentalities or agencies.

(i) "Private line" means a dedicated, non-traffic sensitive, service for a single customer that entitles the customer to the exclusive or priority use of a communications channel or group of channels from one or more specified locations to one or more specified locations.

(j) "Retailer" means the taxpayer and includes every person engaged in the business of making sales of intrastate, interstate, or international telecommunications.

(k) "Sale at retail" means the sale, acquisition, consumption or use of telecommunications, provided that sale at retail does not include (i) the provision of telecommunications among members of an affiliated group of entities by a member of the group for their own exclusive use and consumption; and (ii) carrier access charges, right of access charges, charges for use of intercompany facilities, and charges for all telecommunications resold in the subsequent provision of telecommunications, all of which charges are non-taxable sales for resale. For purposes of applying clause (i), members of an affiliated group include a parent entity and all of the parent entity's wholly owned entities, including wholly owned, sub-tier entities; and "entity" means a non-natural person. For purposes of applying clause (ii), the following are not sales for resale: the acquisition of telecommunications by the member of the group providing the telecommunications to an affiliated group of entities within the meaning of clause (i); and the acquisition of telecommunications by a provider of enhanced services, even when the cost of the telecommunications is separately stated to the purchaser of the enhanced services, as long as the primary object of the sale of the telecommunications to the provider is the provision of enhanced services and not telecommunications..

(l) "Sale of intrastate, interstate, or international telecommunication" means the transmitting, supplying or furnishing of intrastate, interstate, or international telecommunication, respectively, and all services and equipment provided in connection therewith for a consideration to other persons.

(m) "Service address" means the location of the telecommunication equipment from which the telecommunication is originated or at which the telecommunication is received by the taxpayer's purchaser. The foregoing rule is amplified, but not limited, by the following special provisions, which are listed in order of priority of application so that only the first applicable special provision will apply, if more than one potentially applies: (i) if the gross revenue is paid through a credit or payment mechanism that does not relate to a service address of the interstate or international telecommunication (as may be the case when payment of the gross revenue is accomplished by a bank, travel, credit or debit card or when the telecommunication is charged to telecommunication equipment whose location does not constitute a service address of the telecommunication), the service address is deemed to be the location of the origination of the interstate or international telecommunication; (ii) if the service address is not a defined location, as in the case of mobile telephones, paging systems, maritime systems, air-to-ground systems and the like, service address shall mean the location of the subscriber's primary use of the telecommunication equipment as defined by telephone number, authorization code, or location in

this State where bills are sent, *provided, however*, the location of the mobile telephone switching office or similar facility in this State that receives and transmits the signals of the telecommunication will be deemed the service address where the mobile telephone switching office or similar facility is outside the subscriber's assigned service area; and (iii) the service address of private line telecommunication services is deemed to be in this State to the extent gross revenues of such services are attributed to this State.

(n) "State" means either this State or any other State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States.

(o) "Taxpayer" means a person who individually or through agents, employees, independent contractors, officers, representatives, or permittees engages in the business of providing the service of originating or receiving intrastate, interstate, or international telecommunications and who incurs a tax liability under this Act.

(p) "Telecommunication," subject to the exclusions stated in this §1(p), includes, without limitation,

(1) any one way transmission or any two way, interactive transmission of sounds, signals, or other intelligence converted to like form, which effect or are intended to effect meaningful communications by electronic or electromagnetic means via wire, cable, satellite, light waves, microwaves, radio waves or otherwise;

(2) the transmission of messages, programming or information through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunication services; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages, programming or information by electronic or similar means between or among points by wire, cable, fiber-optic, laser, microwave, radio, satellite or similar facilities.

Notwithstanding the foregoing definition of this §1(p), telecommunication does not include enhanced services that are defined as services that employ computer processing applications to act on the format, content, code, or protocol or similar aspects of the information to be transmitted, provide additional, different, or restructured information, or involve the taxpayer's purchaser's interaction with stored information. Under this exception, telecommunication does not include the use of equipment based upon lease or time-sharing agreements, storage of data or information for subsequent retrieval on equipment, or processing of data or information by equipment. Equipment includes, but is not limited to, calculators, computers, data processing equipment, tabulating equipment, or accounting equipment.

2. Imposition of tax-Credit-Exemptions.

(a) A tax is imposed upon the sale at retail of intrastate, interstate, and international telecommunication where the telecommunication is charged to the taxpayer's purchaser's service address in this State at the rate of __% of the gross revenue for such telecommunication.

(b) To prevent actual multijurisdictional taxation of sales subject to tax under this Act, any taxpayer, upon proof that taxpayer or the taxpayer's purchaser has previously paid the same tax in another State on such purchase, shall be allowed a credit against the tax imposed to the extent of the amount of such tax legally imposed in such other State, *provided, however,* the amount of credit will not exceed the tax owed to this State on such purchase.

(c) However, the tax is not imposed to the extent that the sale of intrastate, interstate, and international telecommunications may not, under the Constitution, statutes, or treaties of the United States, be made the subject of transactional taxation by this State. Any taxpayer claiming exemption from the tax by reason of the Constitution, statutes, or treaties of the United States shall file with the Director such claim of exemption as may be prescribed by rule or regulation.

3. Reimbursement of tax.

(a) The taxpayer may be reimbursed for the tax from his purchaser by adding the tax, whenever possible, as a separate and distinct item to the gross revenue charged for the sale of intrastate, interstate, and international telecommunications. **Alternative #4:**[In the case of telecommunication devices requiring the direct deposits of money to operate, reimbursement of the tax may be combined with the direct deposit for the service. The tax imposed by this Act for the sale of intrastate, interstate, and international telecommunication to a person who purchases such service by directly depositing money in telecommunication devices requiring such direct deposits shall be computed each time money is directly deposited.]**:Alternative #4.**

(b) If the tax is separately stated on the books of the taxpayer and the total amount of tax that is separately stated with respect to transactions reportable within one reporting period is in excess of the amount of tax otherwise payable on the transactions on which the tax was separately stated, the excess amount of tax stated on the transactions within that reporting period shall be included as a part of the gross revenues.

Model Recordkeeping and Retention Regulation

Adopted January 15, 1998

••• Reg.VII.1.

1. PURPOSE

1.1 The purpose of this regulation is to define the requirements imposed on taxpayers for the maintenance and retention of books, records, and other sources of information under *[insert appropriate citations to state tax statutes]*. It is also the purpose of the regulation to address these requirements where all or a part of the taxpayer's records are received, created, maintained or generated through various computer, electronic and imaging processes and systems.

2. DEFINITIONS

2.1 For purposes of this regulation, these terms shall be defined as follows:

2.1.1 "Database Management System" means a software system that controls, relates, retrieves, and provides accessibility to data stored in a database.

2.1.2 "Electronic data interchange" or "EDI technology" means the computer-to-computer exchange of business transactions in a standardized structured electronic format.

2.1.3 "Hard copy" means any documents, records, reports or other data printed on paper.

2.1.4 "Machine-sensible record" means a collection of related information in an electronic format. Machine-sensible records do not include hard-copy records that are created or recorded on paper or stored in or by an imaging system such as microfilm, microfiche, or storage-only imaging systems.

2.1.5 "Storage-only imaging system" means a system of computer hardware and software that provides for the storage, retention and retrieval of documents originally created on paper. It does not include any system, or part of a system, that manipulates or processes any information or data contained on the document in any manner other than to reproduce the document in hard copy or as an optical image.

2.1.6 "Taxpayer" as used in this regulation means *[insert state's applicable definition of taxpayer and other persons required to maintain records necessary to determination of tax liability]*.

3. RECORDKEEPING REQUIREMENTS-GENERAL

3.1 A taxpayer shall maintain all records that are necessary to a determination of the correct tax liability under *[insert appropriate citations to state tax statutes]*. All required records must be made available on request by the *[state taxing authority*] or its authorized representatives as provided for in *[insert appropriate citations to state tax statutes]*. Such records shall include, but not be necessarily limited to:

[Insert elements of state law which require certain records to be retained (e.g., books of account, invoices, sales receipts), or specific tax elements or transactions (e.g., credits, exemptions etc.) for which particular records may be required.]

3.2 If a taxpayer retains records required to be retained under this regulation in both machine-sensible and hard-copy formats, the taxpayer shall make the records available to the *[state taxing authority]* in machine-sensible format upon request of the *[state taxing authority]*.

3.3 Nothing in this regulation shall be construed to prohibit a taxpayer from demonstrating tax compliance with traditional hard-copy documents or reproductions thereof, in whole or in part, whether or not such taxpayer also has retained or has the capability to retain records on electronic or other storage media in accordance with this regulation. However, this subsection shall not relieve the taxpayer of the obligation to comply with subsection 3.2 of this regulation.

4. RECORDKEEPING REQUIREMENTS-MACHINE-SENSIBLE RECORDS

4.1 General Requirements

4.1.1 Machine-sensible records used to establish tax compliance shall contain sufficient transaction-level detail information so that the details underlying the machine-sensible records can be identified and made available to the *[state taxing authority]* upon request. A taxpayer has discretion to discard duplicated records and redundant information provided its responsibilities under this regulation are met.

4.1.2 At the time of an examination, the retained records must be capable of being retrieved and converted to a standard record format.

4.1.3 Taxpayers are not required to construct machine-sensible records other than those created in the ordinary course of business. A taxpayer who does not create the electronic equivalent of a traditional paper document in the ordinary course of business is not required to construct such a record for tax purposes.

4.2 Electronic Data Interchange Requirements

4.2.1 Where a taxpayer uses electronic data interchange processes and technology, the level of record detail, in combination with other records related to the transactions, must be equivalent to that contained in an acceptable paper record. For example, the retained records should contain such information as vendor name, invoice date, product description, quantity purchased, price, amount of tax, indication of tax status, shipping detail, etc. Codes may be used to identify some or all of the data elements, provided that the taxpayer provides a method which allows the *[state taxing authority]* to interpret the coded information.

4.2.2 The taxpayer may capture the information necessary to satisfy section 4.2.1 at any level within the accounting system and need not retain the original EDI transaction records provided the audit trail, authenticity, and integrity of the retained records can be established. For example, a taxpayer using electronic data interchange technology receives electronic invoices from its suppliers. The taxpayer decides to retain the invoice data from completed and verified EDI transactions in its accounts payable system rather than to retain the EDI transactions themselves. Since neither the EDI transaction nor the accounts payable system captures information from the invoice pertaining to product description and vendor name (i.e., they contain only codes for that information), the taxpayer also retains other records, such as its vendor master file and product code description lists and makes them available to the *[state taxing authority]*. In this example, the taxpayer need not retain its EDI transaction for tax purposes.

4.3 Electronic Data Processing Systems Requirements

4.3.1 The requirements for an electronic data processing accounting system should be similar to that of a manual accounting system, in that an adequately designed accounting system should incorporate methods and records that will satisfy the requirements of this regulation.

4.4 Business Process Information

4.4.1 Upon the request of the *[state taxing authority]*, the taxpayer shall provide a description of the business process that created the retained records. Such description shall include the relationship between the records and the tax documents prepared by the taxpayer and the measures employed to ensure the integrity of the records.

4.4.2 The taxpayer shall be capable of demonstrating

(a) the functions being performed as they relate to the flow of data through the system;

(b) the internal controls used to ensure accurate and reliable processing; and

(c) the internal controls used to prevent unauthorized addition, alteration, or deletion of retained records.

4.4.3 The following specific documentation is required for machine- sensible records retained pursuant to this regulation:

(a) record formats or layouts;

(b) field definitions (including the meaning of all codes used to represent information);

(c) file descriptions (e.g., data set name); and

(d) detailed charts of accounts and account descriptions.

5. RECORDS MAINTENANCE REQUIREMENTS

5.1 The *[state taxing authority]* recommends but does not require that taxpayers refer to the National Archives and Record Administration's (NARA) standards for guidance on the maintenance and storage of electronic records, such as the labeling of records, the location and security of the storage environment, the creation of back-up copies, and the use of periodic testing to confirm the continued integrity of the records. [The NARA standards may be found at 36 Code of Federal Regulations, Part 1234, July 1, 1995, edition.]

5.2 The taxpayer's computer hardware or software shall accommodate the extraction and conversion of retained machine- sensible records.

6. ACCESS TO MACHINE-SENSIBLE RECORDS

6.1 The manner in which the [*state taxing authority*] is provided access to machine-sensible records as required in subsection 3.2 of this regulation may be satisfied through a variety of means that shall take into account a taxpayer's facts and circumstances through consultation with the taxpayer.

6.2 Such access will be provided in one or more of the following manners:

6.2.1 The taxpayer may arrange to provide the [*state taxing authority*] with the hardware, software and personnel resources to access the machine-sensible records.

6.2.2 The taxpayer may arrange for a third party to provide the hardware, software and personnel resources necessary to access the machine-sensible records.

6.2.3 The taxpayer may convert the machine-sensible records to a standard record format specified by the [*state taxing authority*], including copies of files, on a magnetic medium that is agreed to by the [*state taxing authority*].

6.2.4 The taxpayer and the [*state taxing authority*] may agree on other means of providing access to the machine-sensible records.

7. TAXPAYER RESPONSIBILITY AND DISCRETIONARY AUTHORITY

7.1 In conjunction with meeting the requirements of section 4, a taxpayer may create files solely for the use of the *[state taxing authority]*. For example, if a data base management system is used, it is consistent with this regulation for the taxpayer to create and retain a file that contains the transaction-level detail from the data base management system and that meets the requirements of section 4. The taxpayer should document the process that created the separate file to show the relationship between that file and the original records.

7.2 A taxpayer may contract with a third party to provide custodial or management services of the records. Such a contract shall not relieve the taxpayer of its responsibilities under this regulation.

8. ALTERNATIVE STORAGE MEDIA

8.1 For purposes of storage and retention, taxpayers may convert hard-copy documents received or produced in the normal course of business and required to be retained under this regulation to microfilm, microfiche or other storage-only imaging systems and may discard the original hard-copy documents, provided the conditions of this section are met. Documents which may be stored on these media include, but are not limited to general books of account, journals, voucher registers, general and subsidiary ledgers, and supporting records of details, such as sales invoices, purchase invoices, exemption certificates, and credit memoranda.

8.2 Microfilm, microfiche and other storage-only imaging systems shall meet the following requirements:

8.2.1 Documentation establishing the procedures for converting the hard-copy documents to microfilm, microfiche or other storage-only imaging system must be maintained and made available on request. Such documentation shall, at a minimum, contain a sufficient description to allow an original document to be followed through the conversion system as well as internal procedures established for inspection and quality assurance.

8.2.2 Procedures must be established for the effective identification, processing, storage, and preservation of the stored documents and for making them available for the period they are required to be retained under section 10.

8.2.3 Upon request by the *[state taxing authority]*, a taxpayer must provide facilities and equipment for reading, locating, and reproducing any documents maintained on microfilm, microfiche or other storage-only imaging system.

8.2.4 When displayed on such equipment or reproduced on paper, the documents must exhibit a high degree of legibility and readability. For this purpose, legibility is defined as the quality of a letter or numeral that enables the observer to identify it positively and quickly to the exclusion of all other letters or numerals. Readability is defined as the quality of a group of letters or numerals being recognizable as words or complete numbers.

8.2.5 All data stored on microfilm, microfiche or other storage-only imaging systems must be maintained and arranged in a manner that permits the location of any particular record.

8.2.6 There is no substantial evidence that the microfilm, microfiche or other storage-only imaging system lacks authenticity or integrity.

9. EFFECT ON HARD-COPY RECORDKEEPING REQUIREMENTS

9.1 Except as otherwise provided in this section, the provisions of this regulation do not relieve taxpayers of the responsibility to retain hard-copy records that are created or received in the ordinary course of business as required by existing law and regulations. Hard-copy records may be retained on a recordkeeping medium as provided in section 8 of this regulation.

9.2 If hard-copy records are not produced or received in the ordinary course of transacting business (e.g., when the taxpayer uses electronic data interchange technology), such hard-copy records need not be created.

9.3 Hard-copy records generated at the time of a transaction using a credit or debit card must be retained unless all the details necessary to determine correct tax liability relating to the transaction are subsequently received and retained by the taxpayer in accordance with this regulation. Such details include those listed in subsection 4.2.1.

9.4 Computer printouts that are created for validation, control, or other temporary purposes need not be retained.

9.5 Nothing in this section shall prevent the *[state taxing authority]* from requesting hard-copy printouts in lieu of retained machine-sensible records at the time of examination.

10. RECORDS RETENTION - TIME PERIOD

10.1 All records required to be retained under this regulation shall be preserved pursuant to *[insert adopting state's applicable statutory citation]* unless the *[state taxing authority]* has provided in writing that the records are no longer required.

Appendix I: Explanation and Commentary

The following Explanation and Commentary has not been recommended for adoption by the Multistate Tax Commission as part of the Model Recordkeeping and Retention Regulation. It is provided here for reference purposes only.

Model Recordkeeping And Retention Regulation
EXPLANATION AND COMMENTARY

Section 1. Purpose The purpose is stated as defining the record retention and maintenance requirements imposed under state tax statutes and further to address those requirements as they apply to records created, maintained or received through various computer, electronic and imaging processes and systems.

Section 2. Definitions The following terms are defined: data base management system, electronic data interchange, hard-copy record, machine-sensible record, storage-only imaging systems, and taxpayer.

Section 3. Recordkeeping Requirements - General This section establishes the general recordkeeping requirements imposed on all taxpayers without regard to whether they use paper, computer or electronic processes, systems or technology. The obligation is stated as a requirement to maintain those records necessary to determine the correct tax liability of the taxpayer.

Subsection 3.1 contains the basic requirement to retain all records necessary to the correct determination of tax liability and to make such records available to the state taxing authority. It also allows each state to list specific types of records (e.g., books of account, invoices, sales receipts) or specific tax elements or transactions (e.g., credits, exemptions etc.) for which particular records may be required. Differing specific requirements can be provided for different types of taxes, e.g., motor fuel, sales tax, etc.

Subsection 3.2 provides that where a taxpayer maintains records in both machine-sensible (i.e., electronic) and hard-copy form as part of the normal business process, such taxpayer shall provide the records to the state taxing authority in machine-sensible form upon request. The subsection is intended to insure that the state taxing authority has access to appropriate machine-sensible records for examination purposes should it so desire. State taxing authorities may also request that the appropriate records be provided for examination purposes in hard-copy form. See also subsection 9.5.

Subsection 3.3 further provides that the regulation does not preclude the taxpayer from demonstrating tax compliance with traditional hard-copy documents even if the taxpayer has maintained machine-sensible records. The subsection does not relieve the taxpayer of the obligation to provide machine-sensible records if required under subsection 3.2. It is intended instead to allow a taxpayer to demonstrate tax compliance with information in hard-copy records if such are needed to supplement or clarify information in the machine-sensible records or if it is otherwise determined that use of hard-copy records is the best means of determining the correct tax liability.

Section 4. Recordkeeping Requirements - Machine-Sensible Records This section defines the requirements imposed on taxpayers when relevant records are generated or maintained through electronic means. It contains several subsections:

Subsection 4.1 outlines the general requirements related to the retention of machine- sensible records. *Subsection 4.1.1* requires that machine-sensible records must contain sufficient transaction-level information to allow the records relating to an individual transaction to be identified and made available to the state taxing authority on request. It is understood that for certain taxpayers with large volumes of sales transactions, source detail on individual *sales transactions* may not be available for prior years. Summary reports containing transaction-level detail and documentation on the preparation of the reports from individual transactions should, however, be available under the regulation. Moreover, taxpayers indicate that on a prospective basis, testing of the system and examination of source detail for a finite period could be done.[1] It is expected that individual

transaction- level detail *on purchase transactions* will be available for examination for use tax purposes.

The subsection also authorizes the taxpayer, in his/her discretion, to discard duplicated or redundant records and information. For example, departmental records stored in departmental data files that are duplicated in a central system could be discarded provided that all required information in the departmental records (including the department identification) is contained in the central system and the requirements of the regulation are met. Similarly, daily or weekly data files could be discarded provided that appropriate monthly, quarterly or annual data files with the ability to access appropriate transaction- level records are available.

Subsection 4.1.2 further provides that machine-sensible records must be capable of being retrieved from the computer system and converted to a standard record format that will facilitate use of the records during an examination. This requirement is intended to facilitate the use of computer-assisted audit techniques in examining large volumes of transactions. It is expected that the determination of the precise format of the data and the nature of the access to the electronic records will be determined in conjunction with the taxpayer. [See related items in Section 6.]

Subsection 4.1.3 provides that taxpayers will not be required to create the electronic equivalent of a traditional paper document unless that type of electronic record is created in the normal course of business. For example, taxpayers receiving invoices using electronic data interchange may not create or retain an electronic invoice file. Instead, they may take the data elements, required to be retained pursuant to Section 3.1, from the EDI record and transfer it directly to the accounts payable and other systems without retention of individual invoice data. Under the regulation, the taxpayer could not be required to produce an electronic invoice provided that transaction-level details on the purchase were available. They must, however, be able to provide complete information to determine that the correct tax liability for the transaction was paid.

Subsection 4.2 outlines the requirements for records received through electronic data interchange. *Subsection 4.2.1* provides that for taxpayers using EDI, the level of detail retained from an EDI transaction, in combination with other records related to the transaction, must be equivalent to that required in paper records. For example, the data elements retained would include information on the vendor, commodity purchased, tax paid, etc. Codes may be used to identify some or all of the data elements in the EDI transaction provided the state taxing authority is provided access to any code lists or other information necessary to interpret the transaction. It also provides that if the requirements of the regulation are met, the taxpayer need not retain the original EDI transaction data.

Subsection 4.2.2 provides that the information necessary to satisfy subsection 4.2.1 can be captured at any point in the accounting system, [e.g., invoice-related information can be captured in the accounts payable and other systems, rather than being retained separately] provided that the taxpayer can demonstrate the audit trail, authenticity and integrity of the processes through which the EDI transaction is parceled to the various other systems and that the required data is retained. If the taxpayer is capable of meeting these conditions, the original EDI transaction file need not be retained for examination by the taxing authority.

Subsection 4.3 establishes that electronic data processing accounting systems employed by taxpayers should incorporate methods and records that will satisfy the requirements of the regulation.

Subsection 4.4 provides that the taxpayer, at the request of the state taxing authority, is required to provide a description or documentation of the various business processes involved with the creation, retention and maintenance of the records being examined and the internal controls associated with those systems. *Subsection 4.4.1* provides that the documentation is to include a description of the relationship between the records substantiating tax liability and the tax returns filed by the taxpayer as well as the measures used to ensure the integrity of the records. *Subsection 4.4.2* establishes that the taxpayer must be capable of demonstrating the functions and processes being performed and the flow of data through the various systems as well as the internal controls used to assure reliable and authentic records and to prevent unauthorized alteration of the records. *Subsection 4.4.3* establishes specific documentation requirements for retained machine-sensible records, including record formats, field definitions, code definitions and charts of accounts and associated descriptions.

Section 5. Machine-Sensible Records Maintenance Requirements This section provides general guidance on the maintenance of the electronic

records which are required to be kept or retained. *Subsection 5.1* recommends that taxpayers refer to standards of the National Archives and Records Administration for guidance on the subject. *Subsection 5.2* further provides that the taxpayer's computer hardware and software shall accommodate the extraction and conversion of retained records. The intent of subsection 5.2 is to establish that even as a taxpayer's computer hardware and software change over time, the taxpayer has an obligation to be able to access retained machine-sensible records and provide them to the state taxing authority in a standard record format at the time of an examination.

Section 6. Access to Machine-Sensible Records *Subsection 6.1* provides that the manner in which a state taxing authority is to be provided access to machine-sensible records as required in subsection 3.2 is to be developed in consultation with the taxpayer and reflect the facts and circumstances of each taxpayer. *Subsection 6.2* outlines a variety of alternatives for providing such access including through use of the taxpayer's computer facilities and personnel, use of a third-party, conversion to a format and medium agreed to by the state taxing authority for processing either on-site or off-site with computer resources of the state taxing authority, or such other means as may be determined by the state and the taxpayer. The premise underlying this section is that decisions regarding access to electronic records should be capable of being mutually reached between the state and the taxpayer. These decisions should reflect the needs and preferences of both parties and facilitate the efficient conduct of an examination. In cases where there is an irreconcilable dispute between the taxpayer and the state taxing authority as to the manner in which access is to be provided, state law will control the outcome.

Section 7. Taxpayer Responsibility and Discretionary Authority *Subsection 7.1* provides that in meeting its obligations under the regulation, a taxpayer may create special files for use by the tax authority. This procedure would be used, for example, if a taxpayer chose to create an extract of the transaction-level details in its records for the state taxing authority to use in a computer-assisted audit, instead of allowing the taxing authority to access the records directly. In such a case, the taxing authority would specify the records and data elements it wished to have extracted. *Subsection 7.2* provides that a taxpayer may use a third party to provide record management services. In such cases, a taxpayer retains the obligation to meet the requirements of the regulation.

Section 8. Alternative Storage Medium *Subsection 8.1* provides generally that as an alternative to the retention of paper documents and records, taxpayers may convert such records to microfilm, microfiche and other alternative "storage-only imaging systems." By definition (Section 2), a storage-only imaging system is one that is not designed to and does not include the ability to manipulate or process information in the imaged record other than to print a hard copy of such record, If the requirements of section 8 are met, the taxpayer is not required to retain hard-copy documents converted to alternative storage media for tax purposes.

Subsection 8.2 outlines the specific requirements that such records storage and conversion systems must meet. They include the availability of documentation of the system (§8.2.1), procedures for identifying, processing and storing the imaged documents (§8.2.2), access to facilities for reading, locating and reproducing the stored documents (§8.2.3), standards for readability and legibility of the stored records (§8.2.4), an ability to trace individual documents and records (§8.2.5), and ability to assure the integrity of the records (§8.2.6).

Section 9. Effect on Hard-copy Recordkeeping Requirements This section generally outlines that unless otherwise provided, the regulation does not relieve the taxpayer of retaining hard-copy records received or produced in the normal course of business. *Subsection 9.1* provides that the hard-copy records and documents that have been converted to an alternative storage medium in accord with Section 8 need no longer be retained for tax purposes. *Subsection 9.2* provides that if hard-copy records are not created or produced in the normal course of business, such hard-copy records need not be created. *Subsection 9.3* provides that hard-copy records generated at the time a transaction is entered into using debit cards or credit cards (i.e., sales receipts) must be retained unless all the details necessary to determine correct tax liability regarding the transaction are later received and retained by the taxpayer. The information required would include the vendor, item purchased, tax paid, shipping details, etc. It should not be assumed by taxpayers that the periodic billing statements associated with a credit or debit card will normally provide the required information. *Subsection 9.4* establishes that computer printouts

produced for control or validation purposes need not be retained. *Subsection 9.5* allows the state tax authority to require production of hard-copy records in lieu of machine-sensible records during an examination.

Section 10. Record Retention Periods This section provides that required records shall be retained for the period required under state law unless the state taxing authority provides in writing that they are no longer necessary.

MODEL DIRECT PAYMENT PERMIT REGULATION

Adopted July 28, 2000

A. "Direct payment permit" means a permit issued by [taxing authority] that allows a holder of such permit to accrue and pay state and local taxes under [statute] directly to the [taxing authority].

B. Application for Permit. Applicants for a direct payment permit must apply in writing to the [chief tax administrator]. The application shall be on a form required by the [chief tax administrator] or in a letter containing the applicant's name, address, the location of the place or places of business for which the applicant intends to make direct payment of tax, the sales and use tax account number(s) for which direct payment will be made, and any other information that the [taxing authority] may require.

C. Qualification Process and Requirements.

(1) Applicants for a direct payment permit shall demonstrate the applicant's ability to comply with the [taxing authority] sales and use tax laws and reporting and payment requirements. The applicant must provide a description of the accounting system(s) which will be used by the applicant and demonstrate that the accounting system(s) will reflect the proper amount of tax due.

(2) Applicants must establish a business purpose for seeking a direct payment permit and must demonstrate how direct payment will benefit tax compliance. For example, the utilization of direct payment authority should accomplish one or more of the following:

(a) Reduce the administrative work of determining taxability; collecting, verifying, calculating and/or remitting the tax;
(b) Provide for improved compliance with the tax laws of the [taxing jurisdiction];
(c) Provide for accurate compliance in circumstances where determination of taxability of the item is difficult or impractical at the time of purchase;
(d) Provide for more accurate calculation of the tax where new or electronic business processes such as electronic data interchange, evaluated receipts settlement, or procurement cards are utilized;
(e) Provide for more accurate determination and calculation of tax where significant automation and/or centralization of purchasing and/or accounting processes have occurred and applicant must comply with the laws and regulations of multiple state and local jurisdictions.

(3) The [chief tax administrator] or his/her designee shall review all permit applications. The review of applications shall be conducted in a timely manner so that applicants receive notification of authorization or denial within [30-120] days of the date the [chief tax administrator] or designee receives the application; however if additional documentation or discussion is required, the [chief tax

administrator] or designee shall notify the taxpayer or, at taxpayer's request, schedule a conference with the applicant prior to the end of the [30-120]-day period.

D. Recordkeeping Requirements. A direct payment permit holder shall maintain all records that are necessary to a determination of the correct tax liability under [insert appropriate citations to state tax statutes]. All required records must be made available on request by the [taxing authority] or its authorized representatives as provided for in [insert appropriate citations to state tax statutes].

[Insert elements of state law which require certain records to be retained (e.g., books of account, invoices, sales receipts), or specific tax elements or transactions (e.g., credits) for which particular records may be required.]

E. Reporting of Tax. Each holder of a valid direct payment permit shall, on a form approved by the [taxing authority], accrue and pay directly to the [taxing authority] the taxes due under [statute] for all transactions subject to tax for which a direct payment permit applies. Taxes for which the direct payment permit is used shall be considered due and payable on the sales and use tax return next due following the date on which a determination of taxability is, or in the exercise of reasonable care should be, made for a given transaction, unless otherwise provided by written agreement between the taxpayer and the [taxing authority].

F. Certain Transactions Not Permitted. A holder of a direct pay permit shall not use such permit in connection with the following transactions:

(1) purchases of taxable meals or beverages;

(2) purchases of taxable lodging or services related thereto;

(3) purchases of admissions to places of amusement, entertainment or athletic events, or the privilege of use of amusement devices;

(4) purchases of motor vehicles, or other tangible personal property required to be licensed or titled with a taxing authority, taxed under [taxing authority] statutes [list applicable sections];

(5) purchases of any of the following enumerated services listed in [tax authority] statutes. [List applicable sections. May include services such as telecommunications and utilities.]; and

(6) Such other purchases as may be agreed to between the holder of the direct payment permit and the [taxing authority].

G. Permit Holder's Duties. The holder of a direct payment permit shall furnish a copy of the direct payment permit or other acceptable evidence, if allowed by statute, that the holder has been granted a direct payment permit, including the number of the permit and the date issued, to each vendor from whom the holder purchases tangible personal property or services. Persons who hold a direct

payment permit shall not be required to issue a separate exemption certificate and shall not be required to pay the tax as prescribed in [state taxing statutes related to billing of sales or use tax by vendor].

The holder of a direct payment permit shall have responsibility for accruing and paying tax directly to [taxing authority] on all taxable transactions not taxed at the time of sale. In certain circumstances, it may be necessary for the permit holder to pay tax directly to the vendor. Where tax is paid directly to the vendor and [taxing authority] and permit holder agree, the holder may maintain accounting records in sufficient detail to show in summary, and in respect to each transaction, the amount of sales or use taxes paid to vendors in each reporting period.

H. Vendor's Responsibilities. Receipt of the direct payment permit or other acceptable evidence that the holder has been granted a direct payment permit, shall relieve the vendor of the responsibility of collecting the sales tax on sales made to a direct payment permit holder on qualifying transactions. Vendors and sellers who make sales upon which the tax is not collected by reason of the provisions of this section shall maintain records in such manner that the amount involved and identity of the purchaser may be ascertained. Receipts from such sales shall not be subject to the tax levied in [state taxing statutes related to billing of sales or use tax by vendor].

I. Local Taxes [if imposed]. A direct pay permit holder that makes taxable purchases of tangible personal property or services shall report and pay applicable local sales or use tax on those purchases. The local sales or use tax shall be calculated at the rate imposed by the jurisdiction in which the first taxable use occurs.

J. Revocation of Permit. A direct payment permit is not transferable, and the use of a direct pay permit may not be assigned to a third party. Direct payment permits may be revoked by the [chief tax administrator] at any time whenever the [chief tax administrator] determines that the person holding the permit has not complied with the provisions of this regulation or that the revocation would be in the best interests of the [taxing authority]. Such revocation shall follow the administrative procedures as provided for in [insert appropriate citations to state tax statutes].

Appendix I: Explanation and Commentary

The following Explanation and Commentary has not been recommended for adoption by the Multistate Tax Commission as part of the Model Direct Payment Permit Regulation. It is provided for reference purposes only.

Model Direct Payment Permit Regulation
EXPLANATION AND COMMENTARY

Purpose. The purpose of this regulation is to define the requirements imposed on taxpayers seeking direct payment status. It is also the purpose of this regulation to focus on the business needs of the taxpayer in determining whether direct pay authority should be granted rather than relying on traditional qualification requirements currently in place in many states.

Section A defines "direct payment permit" for purposes of this regulation. The holder of a direct payment permit may make purchases of taxable items for use in its business and defer the taxes imposed until such time as taxability is determined. The permit holder is responsible for accruing and paying state and local taxes directly to the taxing authority based on the requirements of this regulation.

Section B. Application for Permit. This section establishes the process the taxpayer must follow when applying for a direct payment permit and identifies the basic information that must be submitted to the taxing authority. It further provides the taxing authority discretion to require additional information that may be necessary to initiate the application process.

Section C. Qualification Process and Requirements. This section defines the general requirements a taxpayer must meet to qualify for a direct payment permit.

Subsection C (1) requires that a taxpayer demonstrate its ability to comply with the applicable sales and use tax laws and generally be in good standing with the taxing authority. The taxpayer must provide an explanation of the accounting procedures that will be used to determine the taxability of purchases and to ensure that any tax due is correctly accrued and remitted. The taxpayer must maintain records that clearly distinguish between taxable and nontaxable purchases and must demonstrate that the internal controls used will ensure accurate and reliable processing and reporting of the tax liability.[i]

Subsection C (2) focuses on the business needs of the taxpayer in determining whether direct pay authority should be granted. Advanced business processes, such as evaluated receipts settlement (ERS), have allowed businesses to streamline their purchasing and payment processes, but have increased the administrative work of complying with state and local tax laws. This section requires the taxpayer to demonstrate how direct payment authority will benefit tax compliance.

Subsection C (3) provides that the review of all applications for direct payment status be conducted in a timely manner, normally within 30-120 days of receipt of the application. It further states that the taxing authority notify the applicant during the review period if additional information is required to ensure final notification of authorization or denial is provided to the taxpayer on or before the end of the review period.

Section D. Recordkeeping Requirements. This section outlines the recordkeeping requirements of the taxpayer and is consistent with the Model Recordkeeping and Retention Regulation developed by the Task Force.[ii] The taxpayer has an obligation to retain all records necessary to the correct determination of the tax liability and to make such records available to the taxing authority upon request. Each taxing authority may list specific

[i] When entering into sales and use tax compliance agreements, taxpayers and taxing authorities would agree upon a single factor tax rate for the reporting of state and local taxes due for a specified period rather than making a determination of tax due on a per transaction basis.

[ii] See Model Recordkeeping and Retention Regulation, A Report of the Steering Committee, Task Force on EDI Audit and Legal Issues for Tax Administration, published March 1996.

types of records or specific tax elements or transactions for which particular records may be required.

Section E. Reporting of Tax. This section addresses the sales and use tax reporting and payment requirements placed on each holder of a direct payment permit and states that the permit holder is responsible for accruing and reporting tax on all taxable transactions for which a direct payment permit applies. It further states that a taxpayer must exercise reasonable care when determining the point at which tax is due for a given transaction. The term "reasonable" should be defined by each state implementing a direct payment program.

Section F. Certain Transactions Not Permitted. This section identifies transactions for which the direct payment permit may not be issued and for which the permit holder must pay tax directly to the vendor at the time of purchase. Types of transactions not permitted typically include travel and entertainment, motor vehicles, and taxable services, but may include other categories of transactions as designated by the taxing authority. Nothing in this section should be interpreted to override existing tax law or statutes.

Section G. Permit Holder's Duties. This section defines the duties of the taxpayer who has been granted direct payment status by the taxing authority. It states that the permit holder will not be required to pay tax to the vendor on qualifying transactions as long as evidence is provided to the vendor of the permit holder's direct payment status. This may be a copy of the direct payment certificate or other evidence as prescribed by the taxing authority.

This section further states that the permit holder has final responsibility for accruing and paying tax directly to the taxing authority on all taxable transactions not taxed at the time of sale. The permit holder is generally required to issue the direct payment permit to all vendors required to collect tax (except as noted in section F). In some instances, the taxing authority may agree to allow the permit holder to maintain sufficient documentation to show in summary and detail the amount of sales or use taxes paid to vendors in each reporting period.

Section H. Vendor's Responsibilities. This section defines the responsibility of the vendor when making sales to a direct payment permit holder and states that the vendor is relieved of the responsibility of collecting tax on qualifying transactions as long as sufficient detail level information is maintained which supports the tax free sale.

Section I. Local Taxes [if imposed]. This section addresses the responsibility of the direct payment permit holder to accrue and pay applicable local sales or use taxes on purchases of tangible personal property made pursuant to this regulation. It further states that local tax is imposed by the jurisdiction in which the first taxable use occurs. While this is a recommended standard, it is not currently true in all taxing jurisdictions. For example, some taxing authorities may be required to calculate local sales tax at the rate imposed in the jurisdiction in which the sale occurred and calculate local use tax at the rate imposed by the jurisdiction in which the first taxable use occurs. These are examples only, and each taxing authority will address local tax implications related to tangible personal property and services.

Section J. Revocation of Permit. This section provides that direct payment permits are not transferable or assignable, and identifies circumstances for which the taxing authority may revoke direct payment authority. It further defines the responsibility of the permit holder to its vendors upon cancellation or forfeiture of direct payment authority. In cases of business restructuring where ownership and business activities remain unchanged, a direct payment permit will remain in effect for a period of time as determined by the taxing authority to allow the new entity to apply for direct payment status.

Provision for the Collection of Tax on Fundraising Transactions

Adopted July 28, 2000

A. Any nonprofit or charitable organization [*as defined under the State's applicable provisions, which may refer to IRC 501(c)(3), educational, religious or other specific organizations*] making taxable sales of tangible personal property for fundraising shall not be required to collect and remit sales tax due on such sales, provided the wholesaler or distributor is registered with this State as a vendor.

B. Purchases made by a nonprofit or charitable organization of tangible personal property to be sold for fundraising are not to be treated as sales for resale requiring the issuance of a resale exemption certificate.

C. If a nonprofit or charitable organization purchases tangible personal property from a wholesaler or distributor for resale for other than fundraising, the nonprofit or charitable organization must register as a vendor with the State and collect tax on its sales of tangible personal property for other than fundraising. The nonprofit or charitable organization must also provide a resale exemption certificate for these purchases to discharge the obligation of the wholesaler or distributor for collecting and remitting a sales tax on the purchases by the nonprofit or charitable organization.

D. The wholesaler or distributor of tangible personal property to a nonprofit or charitable organization making sales of the tangible personal property for fundraising shall collect and remit the sales tax measured by the selling price of such tangible personal property to the nonprofit or charitable organization. The wholesaler or distributor shall register as a vendor in this State and shall file a return and remit the total amount of taxes collected under this section [*in accordance with the collection/payment provisions of the State sales/use tax act*].

E. As used in this section:

1. "Wholesaler or distributor" means any person engaged in the sale of tangible personal property to a nonprofit or charitable organization that purchases the tangible personal property for fundraising.

2. "Fundraising" shall refer to the irregular or intermittent sale [*as defined by applicable State provisions*] by a nonprofit or charitable organization of tangible personal property for the purpose of obtaining funds from the public for the benefit of the organized purpose of the organization, provided fundraising does not include the sale of tangible personal property by a nonprofit or charitable organization in an unrelated trade, business or activity. Sales of tangible personal property by a nonprofit or charitable organization offered exclusively to its members and not to the general public shall not be considered fundraising under this provision.

F. Examples.

1. Boy Scout Troop A purchases twice in one year, candy, nuts and other items from Wholesaler/Distributor to be sold to the public to raise funds for an annual camping trip. Troop A is a nonprofit organization and does not sell candy in an unrelated trade, business or activity. Under this section, Wholesaler/Distributor Manufacturer is required to collect tax on the items sold to Troop A based on the sales price to Troop A. Troop A is not required to collect sales tax on the sales made to the public.
2. A nonprofit fraternal organization located in State A occasionally purchases from T-Shirt Company clothing imprinted with the organization's emblem to be sold to interested members. The sales to the members would not be considered fundraising sales. The fraternal organization would be required to collect and remit sales tax on the sales made to its members and provide a resale exemption certificate to T-Shirt Company. If the fraternal organization does not provide a resale exemption certificate, T-Shirt Company must collect the use tax due on the goods sold to the organization.

MODEL POLICY STATEMENTS AND GUIDELINES

Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272

Originally adopted by the Multistate Tax Commission on July 11, 1986
Revised version adopted by the MTC Executive Committee on January 22, 1993
Second revision adopted by the Multistate Tax Commission on July 29, 1994

Public Law 86-272, 15 U.S.C. 381-384, (hereafter P.L. 86-272) restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property, which orders are to be sent outside the state for acceptance or rejection, and, if accepted, are filled by shipment or delivery from a point outside the state. The term "net income tax" includes a franchise tax measured by net income. If any sales are made into a state which is precluded by P.L. 86-272 from taxing the income of the seller, such sales remain subject to throwback to the appropriate state which does have jurisdiction to impose its net income tax upon the income derived from those sales.

It is the policy of the state signatories hereto to impose their net income tax, subject to State and Federal legislative limitations, to the fullest extent constitutionally permissible. Interpretation of the solicitation of orders standard in P.L. 86-272 requires a determination of the fair meaning of that term in the first instance. The United States Supreme Court has recently established a standard for interpreting the term "solicitation" and this Statement has been revised to conform to such standard. *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 112 S.Ct. 2447, 120 L.Ed.2d 174 (1992). In those cases where there may be reasonable differences of opinion as to whether the disputed activity exceeds what is protected by P.L. 86-272, the signatory States will apply the principle that the preemption of state taxation that is required by P.L. 86-272 will be limited to those activities that fall within the "clear and manifest purpose of Congress". . *See Department of Revenue of Oregon v. ACF Industries, Inc., et al.*, 510 U.S. 332, 114 S.Ct. 843, 127 L. Ed.2d 165 (1994), *Cipollone* v. *Liggett Group, Inc.*, 505 U.S. 504, 112 S.Ct. 2608, 120 L. Ed.2d 407, 422 (1992)*; Heublein, Inc. v. South Carolina Tax Com.*, 409 U.S. 275, 281-282 (1972).

The following information reflects the signatory states' current practices with regard to: (1) whether a particular factual circumstance is considered under P.L. 86-272 or permitted under this Statement as either protected or not protected from taxation by reason of P.L. 86-272; and (2) the jurisdictional standards which will apply to sales made in another state for purposes of applying a throwback rule (if applicable) with respect to such sales. It is the intent of the signatory states to apply this Statement uniformly to factual circumstances, irrespective of whether such application involves an analysis for jurisdictional purposes in the state into which such tangible personal property has been shipped or delivered or for throwback purposes in the state from which such property has been shipped or delivered.

I
NATURE OF PROPERTY BEING SOLD

Only the solicitation to sell personal property is afforded immunity under P.L. 86-272; therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangibles, such as franchises, patents, copyrights, trade marks, service marks and the like, or any other type of property are not protected activities under P.L. 86-272.

The sale or delivery and the solicitation for the sale or delivery of any type of service that is not either (1) ancillary to solicitation or (2) otherwise set forth as a protected activity under the Section IV.B. hereof is also not protected under Public Law 86-272 or this Statement.

II
SOLICITATION OF ORDERS AND ACTIVITIES ANCILLARY TO SOLICITATION

For the in-state activity to be a protected activity under P.L. 86-272, it must be limited solely to *solicitation* (except for *de minimis* activities described in Article III. and those activities conducted by independent contractors described in Article V. below). Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order.

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. The mere assignment of activities to sales personnel does not, merely by such assignment, make such activities ancillary to solicitation of orders. Additionally, activities that seek to promote *sales* are not ancillary, because P.L. 86-272 does not protect activity that facilitates sales; it only protects ancillary activities that facilitate the request for an order. The conducting of activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from a net income tax afforded by P.L. 86-272, unless the disqualifying activities, taken together, are either *de minimis* or are otherwise permitted under this Statement.

III
DE MINIMIS ACTIVITIES

De minimis activities are those that, when taken together, establish only a trivial connection with the taxing State. An activity conducted within a taxing State on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or non-trivial connection with the State is to be measured on both a qualitative and quantitative basis. If such

activity either qualitatively or quantitatively creates a non-trivial connection with the taxing State, then such activity exceeds the protection of P.L. 86-272. Establishing that the disqualifying activities only account for a relatively small part of the business conducted within the taxing State is not determinative of whether a *de minimis* level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within the taxing State is inconsistent with the limited protection afforded by P.L. 86-272.

IV
SPECIFIC LISTING OF UNPROTECTED AND PROTECTED ACTIVITIES

The following two listings - IV.A. and IV.B. - set forth the in-state activities that are presently treated by the signatory state as "Unprotected Activities" or "Protected Activities". Such listings may be subject to an amendment by addition or deletion that appears on the individual signatory state's Signature Page attached to this Statement. [*Note: a list of states that have adopted this Statement, together with a compilation of such additions and deletions, is available from the MTC*].

The signatory state has included on the list of "Protected Activities" those in-state activities that are either required protection under P.L. 86-272; or, if not so required, that the signatory state, in its discretion, has permitted protection. The mere inclusion of an activity on the listing of "Protected Activities", therefore, is not a statement or admission by the signatory state that said activity is required any protection under the Public Law.

A. UNPROTECTED ACTIVITIES:

The following in-state activities (assuming they are not of a *de minimis* level) are not considered as either solicitation of orders or ancillary thereto or otherwise protected under P.L. 86-272 and will cause otherwise protected sales to lose their protection under the Public Law:

1. Making repairs or providing maintenance or service to the property sold or to be sold.

2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.

3. Investigating credit worthiness.

4. Installation or supervision of installation at or after shipment or delivery.

5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.

6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.

7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.

8. Approving or accepting orders.

9. Repossessing property.

10. Securing deposits on sales.

11. Picking up or replacing damaged or returned property.

12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.

13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.

14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the tax year.

15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.

16. Owning, leasing, using or maintaining any of the following facilities or property in-state:

    a. Repair shop.
    b. Parts department.
    c. Any kind of office other than an in-home office as described as permitted under IV.A.18 and IV.B.2.
    d. Warehouse.
    e. Meeting place for directors, officers, or employees.
    f. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
    g. Telephone answering service that is publicly attributed to the company or to employees or agent(s) of the company in their representative status.
    h. Mobile stores, *i.e.*, vehicles with drivers who are sales personnel making sales from the vehicles.
    i. Real property or fixtures to real property of any kind.

17. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.

18. Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity , and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under Public Law 86-272 or under paragraph IV.B. of this Statement).

    A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity . However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative.

    The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement.

    For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.

20. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other carrier, irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.

21. Conducting any activity not listed in paragraph IV.B. below which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

B. PROTECTED ACTIVITIES:

The following in-state activities will not cause the loss of protection for otherwise protected sales:

1. Soliciting orders for sales by any type of advertising.

2. Soliciting of orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home" office as described in IV.A.18. above.

3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.

4. Furnishing and setting up display racks and advising customers on the display of the company's products without charge or other consideration.

5. Providing automobiles to sales personnel for their use in conducting protected activities.

6. Passing orders, inquiries and complaints on to the home office.

7. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.

8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.

9. Checking of customers' inventories without a charge therefor (for re-order, but not for other purposes such as quality control).

10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the tax year.

11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.

12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.

13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Statement under paragraph IV.B. shall not, by itself, remove the protection under this Statement.

V
INDEPENDENT CONTRACTORS

P.L. 86-272 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded if performed by the company or its employees or other representatives. Independent contractors may engage in the following limited activities in the state without the company's loss of immunity:

1. Soliciting sales.

2. Making sales.

3. Maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under P.L. 86-272 and this Statement .

Maintenance of a stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the company, except for purposes of display and solicitation, shall remove the protection.

VI
APPLICATION OF DESTINATION STATE LAW IN CASE OF CONFLICT

When it appears that two or more signatory states have included or will include the same receipts from a sale in their respective sales factor numerators, at the written request of the company, said states will in good faith confer with one another to determine which state should be assigned said receipts. Such conference shall identify what law, regulation or written guideline, if any, has been adopted in the state of destination with respect to the issue. The state of destination shall be that location at which the purchaser or its designee actually receives the property, regardless of f.o.b. point or other conditions of sale.

In determining which state is to receive the assignment of the receipts at issue, preference shall be given to any clearly applicable law, regulation or written guideline that has been adopted in state of destination. However, except in the case of the definition of what constitutes "tangible personal property", this state is not required by this Statement to follow any other state's law, regulation or written guideline should this state determine that to do so (i) would conflict with its own laws, regulations, or written guidelines and (ii) would not clearly reflect the income-producing activity of the company within this state.

Notwithstanding any provision set forth in this Statement to the contrary, as between this state and any other signatory state, this state agrees to apply the definition of "tangible personal property" that exists in the state of destination to determine the application of P.L. 86-272 and issues of throwback, if any. Should the state of destination not have any applicable definition of such term so that it could be reasonably determined whether the property at issue constitutes "tangible personal property", then each signatory state may treat such property in any manner that would clearly reflect the income-producing activity of the company within said state.

VII
MISCELLANEOUS PRACTICES

A. APPLICATION OF STATEMENT TO FOREIGN COMMERCE.

Public Law 86-272 specifically applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. The states are free, however, to apply the same standards set forth in the Public Law and in this Statement to business activities in foreign commerce to ensure that foreign and interstate commerce are treated on the same basis . Such an application also avoids the necessity of expensive and difficult efforts in the identification and application of the varied jurisdictional laws and rules existing in foreign countries.

This state will apply the provisions of Public Law 86-272 and of this Statement to business activities conducted in foreign commerce. Therefore, whether business activities are conducted by (i) a foreign or domestic company selling tangible personal property into a country outside of the United States from a point within this state or by (ii) either company selling such property into this state from a point outside of the United States, the principles under this Statement apply equally to determine whether the sales transactions are protected and the company immune from taxation in either this state or in the foreign country, as the case might be, and whether, if applicable, this state will apply its throwback provisions.

B. Application to Corporation Incorporated in State or to Person Resident or Domiciled in State.

The protection afforded by P.L. 86-272 and the provisions of this Statement do not apply to any corporation incorporated within this state or to any person who is a resident of or domiciled in this state.

C. Registration or Qualification to Do Business.

A company that registers or otherwise formally qualifies to do business within this state does not, by that fact alone, lose its protection under P.L. 86-272. Where, separate from or ancillary to such registration or qualification, the company receives and seeks to use or protect any additional benefit or protection from this state through activity not otherwise protected under P.L. 86-272 or this Statement, such protection shall be removed.

D. Loss of Protection for Conducting Unprotected Activity During Part of Tax Year.

The protection afforded under P.L. 86-272 and the provisions of this Statement shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conducts activities that are not protected under P.L 86-272 or this Statement, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected from taxation under said Public Law or this Statement.

E. Application of the *Joyce Rule*.

In determining whether the activities of any company have been conducted within this state beyond the protection of P.L. 86-272 or paragraph IV.B. of this Statement, the principle established in *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66), commonly known as the "Joyce Rule", shall apply. Therefore, only those in-state activities that are conducted by or on behalf of said company shall be considered for this purpose. Activities that are conducted by any other person or business entity, whether or not said person or business entity is affiliated with said company, shall not be considered attributable to said company, unless such other person or business entity was acting in a representative capacity on behalf of said company.

Addendum:
Public Law 86-272

••• §381. Imposition of net income tax.

(a) Minimum Standards.

No state or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) Domestic corporations; persons domiciled in or residents of a State.

The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to ----

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident, of such State.

(c) Sales or solicitation of orders for sales by independent contractors.

For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) Definitions.

For purposes of this section ----

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principle and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

••• §382. Assessment of net income taxes; limitations; collection.

(a) No State, or political subdivision thereof, shall have power to assess, after September 14, 1959, any net income tax which was imposed by such State or political subdivision, as the case may be, for any taxable year ending on or before such date, on the income derived within such State by any person from interstate commerce, if the imposition of such tax for a taxable year ending after such date is prohibited by section 381 of this title.

(b) the provisions of subsection (a) of this section shall not be construed ----

(1) to invalidate the collection, on or before September 14, 1959, of any net income tax imposed for a taxable year ending on or before such date, or

(2) to prohibit the collection, after September 14, 1959, of any net income tax which was assessed on or before such date for a taxable year ending on or before such date.

••• .§383. Definition.

For purpose of this chapter, the term "net income tax" means any tax imposed on, or measured by net income.

••• §384. Separability of provisions.

If any provision of this chapter or the application of such provision to any person or circumstance is held invalid, the remainder of this chapter or the application of such provision to persons or circumstances other than those to which it is held invalid, shall not be affected thereby.

Applicability of Sales and/or Use Tax to Sales of Computer Software

Adopted July 14, 1988

Policy Statement

This guideline sets forth the policy of each state which adopts its as to the manner in which that state applies its sales/use tax to computer software. Such states are designated herein as signatory states.

Objective

It is the purpose of this guideline to further the cause of uniformity and predictability in the manner in which states treat computer software for purposes of sales and use taxation.

The Problem

Many states subject sales of tangible personal property to sales and use tax but exempt from such taxes sales of intangible personal property and sales of services. Distinguishing between the two types of transactions, i.e. taxable and non-taxable, is often difficult. This is particularly true with respect to computer software; and the states have sometimes reached differing conclusions on the basis of the same facts.

Goal

This guideline seeks to establish a uniform standard by which the signatory states will distinguish between canned and custom sales of computer software. It is relevant for only those states which differentiate between the two for the purpose of distinguishing between taxable and non-taxable sales of computer software.

Definitions

Computer, as used here, means a programmable machine or device (including word processing equipment and testing equipment) having information processing capabilities and usually consisting of a central processing unit, internal memory and input and output peripherals. The term includes a programmable microprocessor and/or any other integrated circuit embedded in manufactured machinery or equipment.

Computer software, as used here, means and includes programming, i.e., a set of statements or instructions which, when incorporated into a machine-usable data processing storage or communication medium or device (such as printed material, cards, disks, tapes or modems), is capable of causing a computer to indicate, perform or achieve a particular function, task or result.

Custom software, as used here, means and includes programming which results when a user purchases the services of a person to create software which is specialized to meet the user's particular needs. The term includes those services that are represented by separately stated and identified charges for those modifications to an existing pre-written program which are made to the special order of the customer, even though the sale, lease or license to use the existing program remains taxable. The signatory states treat the sale of custom software as a sale of services on the basis: 1) that the user has purchased not tangible personal property but services; and 2) that the resulting software is simply the means by which those services are delivered to the user.

Canned software, as used here, means and includes programming that has general applicability and/or has not been prepared at the special request of the purchaser to meet his particular needs. It is sometimes known and/or described as "pre-written programming." Evidence of general applicability is to be found in the selling, licensing and/or leasing of the identical program more than once. A program may qualify as custom software for the original purchaser/lessee/licensee but became canned software with respect to all others. The signatory states treat the sale of canned software as either a taxable sale of, lease of or license to use tangible personal property. Examples of prominent canned programs are: Bank Street, Crossfire, D-Base III, DOS, Electric Desk, Fun Pack, Kings's Quest, Lisa, Lotus 1-2-3, MacEdge, MacPaint, MacPhone, MacVegas, MacWrite, MegaMerge, Soft Maker II, Solomon II, Ventura, Word Perfect, Word Proof, Wordstar, and Writing Assistant (IBM).

Licensing/Leasing Agreements

Whether a software licensing or leasing agreement is subject to tax depends, in some states, upon whether the software itself is custom or canned software.

THE MULTISTATE TAX COMPACT

THE MULTISTATE TAX COMPACT

Entered into force August 4, 1967

Article I. Purposes.

The purposes of this compact are to:

1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation.

Article II. Definitions.

As used in this compact:

1. "State" means a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any Territory or Possession of the United States.

2. "Subdivision" means any governmental unit or special district of a State.

3. "Taxpayer" means any corporation, partnership, firm, association, governmental unit or agency or person acting as a business entity in more than one State.

4. "Income tax" means a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions.

5. "Capital stock tax" means a tax measured in any way by the capital of a corporation considered in its entirety.

6. "Gross receipts tax" means a tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which no deduction is allowed which would constitute the tax an income tax.

7. "Sales tax" means a tax imposed with respect to the transfer for a consideration of ownership, possession or custody of tangible personal property or the rendering of services measured by the price of the tangible personal property transferred or services rendered and which is required by State or local law to be separately stated from the sales price by the seller, or which is customarily separately stated from the sales price, but does not include a tax imposed exclusively on the sale of a specifically identified commodity or article or class of commodities or articles.

8. "Use tax" means a nonrecurring tax, other than a sales tax, which (a) is imposed on or with respect to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership, possession or custody of that property or the leasing of that property from another including any consumption, keeping, retention, or other use of tangible personal property and (b) is complementary to a sales tax.

9. "Tax" means an income tax, capital stock tax, gross receipts tax, sales tax, use tax, and any other tax which has a multistate impact, except that the provisions of Articles III, IV and V of this compact shall apply only to the taxes specifically designated therein and the provisions of Article IX of this compact shall apply only in respect to determinations pursuant to Article IV.

Article III. Elements of Income Tax Laws.

Taxpayer Option, State and Local Taxes.

1. Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State or pursuant to the laws of subdivisions in two or more party States may elect to apportion and allocate his income in the manner provided by the laws of such States or by the laws of such States and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with Article IV. This election for any tax year may be made in all party States or subdivisions thereof or in any one or more of the party States or subdivisions thereof without reference to the election made in the others. For the purposes of this paragraph, taxes imposed by subdivisions shall be considered separately from State taxes, and the apportionment and allocation also may be applied to the entire tax base. In no instance wherein Article IV is employed for all subdivisions of a State may the sum of all apportionments and allocations to subdivisions within a State be greater than the apportionment and allocation that would be assignable to that State if the apportionment or allocation were being made with respect to a State income tax.

Taxpayer Option, Short Form.

2. Each party State or any subdivision thereof which imposes an income tax shall provide by law that any taxpayer required to file a return whose only activities within the taxing jurisdiction consist of sales and do not include owning or renting real estate or tangible personal

property and whose dollar volume of gross sales made during the tax year within the State or subdivision, as the case may be, is not in excess of $100,000 may elect to report and pay any tax due on the basis of a percentage of such volume and shall adopt rates which shall produce a tax which reasonably approximates the tax otherwise due. The Multistate Tax Commission, not more than once in five years, may adjust the $100,000 figure in order to reflect such changes as may occur in the real value of the dollar, and such adjusted figure, upon adoption by the Commission, shall replace the $100,000 figure specifically provided herein. Each party State and subdivision thereof may make the same election available to taxpayers additional to those specified in this paragraph.

Coverage.

3. Nothing in this Article relates to the reporting or payment of any tax other than an income tax.

Article IV. Division of Income.

1. As used in this Article, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.

(e) "Nonbusiness income" means all income other than business income.

(f) "Public utility" means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipeline, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or approved by a Federal, State or local government or governmental agency.

(g) "Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.

(h) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any Territory or Possession of the United States, and any foreign country or political subdivision thereof.

(i) "This State" means the State in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and without this State, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this Article, the taxpayer may elect to allocate and apportion his entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another State if (1) in that State he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that State has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the State does or does not do so.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in paragraphs 5 through 8 of this Article.

5. (a) Net rents and royalties from real property located in this State are allocable to this State.

(b) Net rents and royalties from tangible personal property are allocable to this State: (1) if and to the extent that the property is utilized in this State, or (2) in their entirety if the taxpayers's commercial domicile is in this State and the taxpayer is not organized under the laws of or taxable in the State in which the property is utilized.

(c) The extent of utilization of tangible personal property in a State is determined by multiplying the rents and royalties by a fraction the numerator of which is the number of days of physical location of the property in the State during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the State in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this State are allocable to this State.

(b) Capital gains and losses from sales of tangible personal property are allocable to this State if (1) the property had a situs in this State at the time of the sale, or (2) the taxpayer's commercial domicile is in this State and the taxpayer is not taxable in the State in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this State if the taxpayer's commercial domicile is in this State.

7. Interest and dividends are allocable to this State if the taxpayer's commercial domicile is in this State.

8. (a) Patent and copyright royalties are allocable to this State: (1) if and to the extent that the patent or copyright is utilized by the payer in this State, or (2) if and to the extent that the patent or copyright is utilized by the payer in a State in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

(b) A patent is utilized in a State to the extent that it is employed in production, fabrication, manufacturing, or other processing in the State or to the extent that a patented product is produced in the State. If the basis of receipts from patent royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the patent is utilized in the State in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a State to the extent that printing or other publication originates in the State. If the basis of receipts from copyright royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the copyright is utilized in the State in which the taxpayer's commercial domicile is located.

9. All business income shall be apportioned to this State by multiplying the income by a fraction the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

10. The property factor is a fraction the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction the numerator of which is the total amount paid in this State during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this State if:

(a) the individual's service is performed entirely within the State;

(b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or

(c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this State.

15. The sales factor is a fraction the numerator of which is the total sales of the taxpayer in this State during the tax period and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this State if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this State regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the State of the purchaser.

17. Sales, other than sales of tangible personal property, are in this State if:

(a) the income-producing activity is performed in this State; or

(b) the income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other State, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article V. Elements of Sales and Use Tax Laws.

Tax Credit.

1. Each purchaser liable for a use tax on tangible personal property shall be entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid by him with respect to the same property to another State and any subdivision thereof. The credit shall be applied first against the amount of any use tax due the State, and any unused portion of the credit shall then be applied against the amount of any use tax due a subdivision.

Exemption Certificates. Vendors May Rely.

2. Whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate State or subdivision taxing authority, the vendor shall be relieved of liability for a sales or use tax with respect to the transaction.

Article VI. The Commission.

Organization and Management.

1. (a) The Multistate Tax Commission is hereby established. It shall be composed of one "member" from each party State who shall be the head of the State agency charged with the administration of the types of taxes to which this compact applies. If there is more than one such agency, the State shall provide by law for the selection of the Commission member from the heads of the relevant agencies. State law may provide that a member of the Commission be represented by an alternate, but only if there is on file with the Commission written notification of the designation and identity of the alternate. The Attorney General of each party State or his

designee, or other counsel if the laws of the party State specifically provide, shall be entitled to attend the meetings of the Commission, but shall not vote. Such Attorneys General, designees, or other counsel shall receive all notices of meetings required under paragraph 1(e) of this Article.

(b) Each party State shall provide by law for the selection of representatives from its subdivisions affected by this compact to consult with the Commission member from that State.

(c) Each member shall be entitled to one vote. The Commission shall not act unless a majority of the members are present, and no action shall be binding unless approved by a majority of the total number of members.

(d) The Commission shall adopt an official seal to be used as it may provide.

(e) The Commission shall hold an annual meeting and such other regular meetings as its bylaws may provide and such special meetings as its Executive Committee may determine. The Commission bylaws shall specify the dates of the annual and any other regular meetings and shall provide for the giving of notice of annual, regular and special meetings. Notices of special meetings shall include the reasons therefor and an agenda of the items to be considered.

(f) The Commission shall elect annually, from among its members, a Chairman, a Vice Chairman and a Treasurer. The Commission shall appoint an Executive Director who shall serve at its pleasure, and it shall fix his duties and compensation. The Executive Director shall be Secretary of the Commission. The Commission shall make provision for the bonding of such of its officers and employees as it may deem appropriate.

(g) Irrespective of the civil service, personnel or other merit system laws of any party State, the Executive Director shall appoint or discharge such personnel as may be necessary for the performance of the functions of the Commission and shall fix their duties and compensation. The Commission bylaws shall provide for personnel policies and programs.

(h) The Commission may borrow, accept or contract for the services of personnel from any State, the United States, or any other governmental entity.

(i) The Commission may accept for any of its purposes and functions any and all donations and grants of money, equipment, supplies, materials and services, conditional or otherwise, from any governmental entity, and may utilize and dispose of the same.

(j) The Commission may establish one or more offices for the transacting of its business.

(k) The Commission shall adopt bylaws for the conduct of its business. The Commission shall publish its bylaws in convenient form and shall file a copy of the bylaws and any amendments thereto with the appropriate agency or officer in each of the party States.

(l) The Commission annually shall make to the Governor and legislature of each party State a report covering its activities for the preceding year. Any donation or grant accepted by the Commission or services borrowed shall be reported in the annual report of the Commission and shall include the nature, amount and conditions, if any, of the donation, gift, grant or services borrowed and the identity of the donor or lender. The Commission may make additional reports as it may deem desirable.

Committees.

2. (a) To assist in the conduct of its business when the full Commission is not meeting, the Commission shall have an Executive Committee of seven members, including the Chairman, Vice Chairman, Treasurer and four other members elected annually by the Commission. The Executive Committee, subject to the provisions of this compact and consistent with the policies of the Commission, shall function as provided in the bylaws of the Commission.

(b) The Commission may establish advisory and technical committees, membership on which may include private persons and public officials, in furthering any of its activities. Such committees may consider any matter of concern to the Commission, including problems of special interest to any party State and problems dealing with particular types of taxes.

(c) The Commission may establish such additional committees as its bylaws may provide.

Powers.

3. In addition to powers conferred elsewhere in this compact, the Commission shall have power to:

(a) Study State and local tax systems and particular types of State and local taxes.

(b) Develop and recommend proposals for an increase in uniformity or compatibility of State and local tax laws with a view toward encouraging the simplification and improvement of State and local tax law and administration.

(c) Compile and publish such information as would, in its judgment, assist the party States in implementation of the compact and taxpayers in complying with State and local tax laws.

(d) Do all things necessary and incidental to the administration of its functions pursuant to this compact.

Finance.

4. (a) The Commission shall submit to the Governor or designated officer or officers of each party State a budget of its estimated expenditures for such period as may be required by the laws of that State for presentation to the legislature thereof.

(b) Each of the Commission's budgets of estimated expenditures shall contain specific recommendations of the amounts to be appropriated by each of the party States. The total amount of appropriations required under any such budget shall be apportioned among the party States as follows: one-tenth in equal shares; and the remainder in proportion to the amount of revenue collected by each party State and its subdivisions from income taxes, capital stock taxes, gross receipts taxes, sales and use taxes. In determining such amounts, the Commission shall employ such available public sources of information as, in its judgment, present the most equitable and accurate comparisons among the party States. Each of the Commission's budgets of estimated expenditures and requests for appropriations shall indicate the sources used in obtaining information employed in applying the formula contained in this paragraph.

(c) The Commission shall not pledge the credit of any party State. The Commission may meet any of its obligations in whole or in part with funds available to it under paragraph 1(i) of this Article; provided that the Commission takes specific action setting aside such funds prior to incurring any obligation to be met in whole or in part in such manner. Except where the Commission makes use of funds available to it under paragraph 1(i), the Commission shall not incur any obligation prior to the allotment of funds by the party States adequate to meet the same.

(d) The Commission shall keep accurate accounts of all receipts and disbursements. The receipts and disbursements of the Commission shall be subject to the audit and accounting procedures established under its bylaws. All receipts and disbursements of funds handled by the Commission shall be audited yearly by a certified or licensed public accountant and the report of the audit shall be included in and become part of the annual report of the Commission.

(e) The accounts of the Commission shall be open at any reasonable time for inspection by duly constituted officers of the party States and by any persons authorized by the Commission.

(f) Nothing contained in this Article shall be construed to prevent Commission compliance with laws relating to audit or inspection of accounts by or on behalf of any government contributing to the support of the Commission.

Article VII. Uniform Regulations and Forms.

1. Whenever any two or more party States or subdivisions of party States have uniform or similar provisions of law relating to an income tax, capital stock tax, gross receipts tax, or sales or use tax, the Commission may adopt uniform regulations for any phase of the administration of such law, including assertion of jurisdiction to tax or prescribing uniform tax forms. The Commission may also act with respect to the provisions of Article IV of this compact.

2. Prior to the adoption of any regulation, the Commission shall:

(a) As provided in its bylaws, hold at least one public hearing on due notice to all affected party States and subdivisions thereof and to all taxpayers and other persons who have made timely request of the Commission for advance notice of its regulation-making proceedings.

(b) Afford all affected party States and subdivisions and interested persons an opportunity to submit relevant written data and views, which shall be considered fully by the Commission.

3. The Commission shall submit any regulations adopted by it to the appropriate officials of all party States and subdivisions to which they might apply. Each such State and subdivision shall consider any such regulation for adoption in accordance with its own laws and procedures.

Article VIII. Interstate Audits.

1. Any party State or subdivision thereof desiring to make or participate in an audit of any accounts, books, papers, records or other documents may request the Commission to perform the audit on its behalf. In responding to the request, the Commission shall have access to and may examine, at any reasonable time, such accounts, books, papers, records, and other documents and any relevant property or stock of merchandise. The Commission may enter into agreements with party States or their subdivisions for assistance in performance of the audit. The Commission shall make charges, to be paid by the State or local government or governments for which it performs the service, for any audits performed by it in order to reimburse itself for the actual costs incurred in making the audit.

2. The Commission may require the attendance of any person within the State where it is conducting an audit or part thereof at a time and place fixed by it within such State for the purpose of giving testimony with respect to any account, book, paper, document, other record, property or stock of merchandise being examined in connection with the audit. If the person is not within the jurisdiction, he may be required to attend for such purpose at any time and place fixed by the Commission within the State of which he is a resident.

3. The Commission may apply to any court having power to issue compulsory process for orders in aid of its powers and responsibilities pursuant to this Article, and any and all such courts shall have jurisdiction to issue such orders. Failure of any person to obey any such order shall be

punishable as contempt of the issuing court. If the party or subject matter on account of which the Commission seeks an order is within the jurisdiction of the court to which application is made, such application may be to a court in the State or subdivision on behalf of which the audit is being made or a court in the State in which the object of the order being sought is situated.

4. The Commission may decline to perform any audit required if it finds that its available personnel or other resources are insufficient for the purpose or that, in the terms requested, the audit is impracticable of satisfactory performance. If the Commission, on the basis of its experience, has reason to believe that an audit of a particular taxpayer, either at a particular time or on a particular schedule, would be of interest to a number of party States or their subdivisions, it may offer to make the audit or audits, the offer to be contingent upon sufficient participation therein as determined by the Commission.

5. Information obtained by any audit pursuant to this Article shall be confidential and available only for tax purposes to party States, their subdivisions or the United States. Availability of information shall be in accordance with the laws of the States or subdivisions on whose account the Commission performs the audit and only through the appropriate agencies or officers of such States or subdivisions. Nothing in this Article shall be construed to require any taxpayer to keep records for any period not otherwise required by law.

6. Other arrangements made or authorized pursuant to law for cooperative audit by or on behalf of the party States or any of their subdivisions are not superseded or invalidated by this Article.

7. In no event shall the Commission make any charge against a taxpayer for an audit.

8. As used in this Article, "tax," in addition to the meaning ascribed to it in Article II, means any tax or license fee imposed in whole or in part for revenue purposes.

Article IX. Arbitration.

1. Whenever the Commission finds a need for settling disputes concerning apportionments and allocations by arbitration, it may adopt a regulation placing this Article in effect, notwithstanding the provisions of Article VII.

2. The Commission shall select and maintain an Arbitration Panel composed of officers and employees of State and local governments and private persons who shall be knowledgeable and experienced in matters of tax law and administration.

3. Whenever a taxpayer who has elected to employ Article IV, or whenever the laws of the party State or subdivision thereof are substantially identical with the relevant provisions of Article IV, the taxpayer, by written notice to the Commission and to each party State or subdivision thereof that would be affected, may secure arbitration of an apportionment or allocation if he is dissatisfied with the final administrative determination of the tax agency of the

State or subdivision with respect thereto on the ground that it would subject him to double or multiple taxation by two or more party States or subdivisions thereof. Each party State and subdivision thereof hereby consents to the arbitration as provided herein, and agrees to be bound thereby.

4. The Arbitration Board shall be composed of one person selected by the taxpayer, one by the agency or agencies involved, and one member of the Commission's Arbitration Panel. If the agencies involved are unable to agree on the person to be selected by them, such person shall be selected by lot from the total membership of the Arbitration Panel. The two persons selected for the Board in the manner provided by the foregoing provisions of this paragraph shall jointly select the third member of the Board. If they are unable to agree on the selection, the third member shall be selected by lot from among the total membership of the Arbitration Panel. No member of a Board selected by lot shall be qualified to serve if he is an officer or employee of or is otherwise affiliated with any party to the arbitration proceeding. Residence within the jurisdiction of a party to the arbitration proceeding shall not constitute affiliation within the meaning of this paragraph.

5. The Board may sit in any State or subdivision party to the proceeding, in the State of the taxpayer's incorporation, residence or domicile, in any State in which the taxpayer does business, or in any place that it finds most appropriate for gaining access to evidence relevant to the matter before it.

6. The Board shall give due notice of the times and places of its hearings. The parties shall be entitled to be heard, to present evidence, and to examine and cross-examine witnesses. The Board shall act by majority vote.

7. The Board shall have power to administer oaths, take testimony, subpoena and require the attendance of witnesses and the production of accounts, books, papers, records, and other documents, and issue commissions to take testimony. Subpoenas may be signed by any member of the Board. In case of failure to obey a subpoena, and upon application by the Board, any judge of a court of competent jurisdiction of the State in which the Board is sitting or in which the person to whom the subpoena is directed may be found may make an order requiring compliance with the subpoena, and the court may punish failure to obey the order as a contempt.

8. Unless the parties otherwise agree, the expenses and other costs of the arbitration shall be assessed and allocated among the parties by the Board in such manner as it may determine. The Commission shall fix a schedule of compensation for Arbitration Board members and of other allowable expenses and costs. No officer or employee of a State or local government who serves as a member of a Board shall be entitled to compensation therefor unless he is required on account of his service to forego the regular compensation attaching to his public employment, but any such Board member shall be entitled to expenses.

9. The Board shall determine the disputed apportionment or allocation and any matters necessary thereto. The determinations of the Board shall be final for purposes of making the apportionment or allocation, but for no other purpose.

10. The Board shall file with the Commission and with each tax agency represented in the proceeding: the determination of the Board; the Board's written statement of its reasons therefor; the record of the Board's proceedings; and any other documents required by the arbitration rules of the Commission to be filed.

11. The Commission shall publish the determinations of Boards together with the statements of the reasons therefor.

12. The Commission shall adopt and publish rules of procedure and practice and shall file a copy of such rules and of any amendment thereto with the appropriate agency or officer in each of the party States.

13. Nothing contained herein shall prevent at any time a written compromise of any matter or matters in dispute, if otherwise lawful, by the parties to the arbitration proceedings.

Article X. Entry Into Force and Withdrawal.

1. This compact shall enter into force when enacted into law by any seven States. Thereafter, this compact shall become effective as to any other State upon its enactment thereof. The Commission shall arrange for notification of all party States whenever there is a new enactment of the compact.

2. Any party State may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal.

3. No proceeding commenced before an Arbitration Board prior to the withdrawal of a State and to which the withdrawing State or any subdivision thereof is a party shall be discontinued or terminated by the withdrawal, nor shall the Board thereby lose jurisdiction over any of the parties to the proceeding necessary to make a binding determination therein.

Article XI. Effect on Other Laws and Jurisdiction.

Nothing in this compact shall be construed to:

(a) Affect the power of any State or subdivision thereof to fix rates of taxation, except that a party State shall be obligated to implement Article III 2 of this compact.

(b) Apply to any tax or fixed fee imposed for the registration of a motor vehicle or any tax on motor fuel, other than sales tax; provided that the definition of "tax" in Article VIII 9 may apply for the purposes of that Article and that the Commission's powers of study and recommendation pursuant to Article VI 3 may apply.

(c) Withdraw or limit the jurisdiction of any State or local court or administrative officer or body with respect to any person, corporation or other entity or subject matter, except to the extent that such jurisdiction is expressly conferred by or pursuant to this compact upon another agency or body.

(d) Supersede or limit the jurisdiction of any court of the United States.

Article XII. Construction and Severability.

This compact shall be liberally construed so as to effectuate the purposes thereof. The provisions of this compact shall be severable and if any phrase, clause, sentence, or provision of this compact is declared to be contrary to the constitution of any State or of the United States or the applicability thereof to any government, agency, person or circumstance is held invalid, the validity of the remainder of this compact and the applicability thereof to any government, agency, person or circumstance shall not be affected thereby. If this compact shall be held contrary to the constitution of any State participating therein, the compact shall remain in full force and effect as to the remaining party States and in full force and effect as to the State affected as to all severable matters.